



IOTA

Intra-European Organisation
of Tax Administrations

IOTA Case Study Workshop

"Advanced Transfer Pricing Issues"

Case Studies

29 - 30 April 2026
Budapest, Hungary



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CASE STUDY 1- Albania

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Background - Description of the Case:

The case concerns Company 1, an Armenian subsidiary of a global group headquartered in the United Arab Emirates. Auditors commissioned by the Albanian tax administration, began audit operations at the offices of the company Natyra.Albania. The object of the audit was to assess the arm's length character of the controlled transactions that were carried out between Natyra.Albania and related companies.

Natyra.Albania has as its main activity the distribution of “Natyra.Cosmetic”CO products in the territory of Albania. The purchase of products from “Natyra Cosmetic” Romania. and the provision of support services from “Natyra Cosmetics” Poland were the main controlled transactions.

Based on the domestic documentation submitted, Natyra.Albania is a limited risk distributor, which performs simple functions and bears limited risks. In the years 2023 -2024 the operating margin of the distribution activity was 1.69%.

In order to test this value, Natyra Albania has chosen the Net Transaction Price Method (TNMM) as the most reliable method for this case.

For this reason, Natyra.Albania identified a group of comparable companies by using the data program “Amadeus” and chose the operating margin as an indicator of the level of profit. Since 1.69% was within the range of comparable values identified, Natyra.Albania considered the transfer prices in accordance with the arm’s length standards.

The facts found by the auditors, as well as the analysis carried out by the Inspectors: In particular, Natyra.Albania turned out to be a distributor, which performs simple distribution functions, but bears a higher risk than a distributor with limited risk.

In addition, the calculation of the operating margin reported in the domestic documentation was not correct, as the calculation did not include employee costs and depreciation. Based on the new calculations, the operating margin was -3.23%. The auditors also identified several critical issues in the comparability research conducted.

Due to these issues, the comparability analysis conducted by the company is not reliable and cannot be accepted by the Albanian Tax Authorities. For the reasons described above, the auditors conducted another search using the Orbis data program. As a result of the search, a group of 6 comparable Cosmetics distributors in the Balkans was identified. The table below shows the range identified.

Gama IQ
MIN 1.22%
IQ 1.87%
MED 3.59%
IIIQ 6.12%
MAX 7.86%

Since in 2024 the operating margin (OM) of Natyra Albania falls outside the market range, The auditors issued an assessment on the taxation of the company's income for the year 2024. The assessment was determined as follows:

EURO
2,455,800
OM % -3.23%
OM - - 79,322
OM % Arm's length 3.59%
OM Arm's length 88,163.
ASSESSMENT 2024 167,485.56

Summary of Transfer Pricing documentation submitted by the Company. Auditing company EX. performed the following operations in order to perform functional and economic analyses.

- interviews and discussions with relevant employees of Natyra AL.
- review of financial documents and information provided by Natyra AL
- review of publicly available information about the Natyra Cosmetics group. and Natyra Albania.
- research for functionally comparable companies.

Functional Analysis

NATYRA COSMETICS.CO and its subsidiaries manufacture, market and distribute beauty, fashion and household products. To distribute products in the European, Middle East and Africa region, the NATYRA COSMETICS group relies on subsidiaries with distribution centers. Finished products are sent from these distribution centers to independent sales representatives to fulfill their orders. Each distribution center serves specific markets.

Natyra.Albania, which is a limited risk distributor, purchases goods from Natyra Romania, which is a Distribution Center, which also provides warehousing and logistics services for Albania. Natyra Albania also receives services from Natyra Poland, Natyra Hungary, Natyra Serbia and Natyra Bulgaria. These services include marketing, sales support, accounting, IT support, reporting and control, legal, managerial, financial, administrative and regulatory support services.

Economic Analysis

As a result of the analysis performed, the Audit Company divided the activities performed by Natyra Albania into two different activities: distribution activity and provision of regional support services.

Distribution activities of Natyra Albania.

Natyra Albania acts as a limited risk distributor on the territory of Albania. In reviewing the compliance of Natyra Albania's remuneration for distribution activities, the Audit Company selected TNMM as the most appropriate method and selected Natyra Albania as the tested party.

For this purpose, the Audit Company conducted a search using the Amadeus data program, in order to identify comparable operating companies, operating in economic circumstances comparable to Natyra Albania.

Operating Margin (OM) was selected as an indicator of the level of profit. As a result of the search conducted, the Auditing company EX identified a group of 7 comparable distributors, whose MO range is between 0.02 and 2.73.

The local documentation states that "Natyra Albania has a MO of 1.69% in 2024, which falls within the above range".

Natyra Albania's Operating Margin (OM) Calculations for 2024

Natyra Albania Sh.p.k

Financial summary for calculating the Operating Margin for the year 2024

Në Euro (milionë)

Sales (SH) 343.811

Cost of goods sold 221.938

Gross profit (GP) 121.873

Operating expenses (OE) 116.051

Total expenses (TE) 337.989

Operating profit 5.822

Operating margin (O/S) 1.69%

The table below shows the arm's length range identified with the research conducted by the Audit Company.

Regional Wholesale Distributors

Three – Year

Simple Average of MO Ratio (2021-2022-2023)

Model Size(number) 7

Minimumi (%) 0.02

Lowest Quartile(%) (%) 1.37

Upper Quartile((%) 2.54

Maximum (%) %) 2.73

Provision of regional support services.

Natyra Poland, Avon Hungary, Avon Serbia, Avon Bulgaria charge a mark-up on costs of 6.5% for the provision of regional services.

Having assessed the compliance of the NATYRA COSMETICS group policy with the arm's length principle, the Audit Company chose the cost plus (CP) method as the most appropriate method and selected the providers of support services of Natyra Al. as the tested party "because the profit attributable to their controlled transactions can be reliably controlled". Mark-up on total costs (MTC) has been chosen as an indicator of the level of profit (TNF).

As a result of the research carried out, the Audit Company identified 14 companies whose TNF "for support services" varies between 0.5% and 31.2%. The Auditing Company also identified a sample of 16 "IT support services" companies, whose TNF ranges between 0.5% and 16.5%. Natyra Cosmetics service providers receive a 6.5% markup on total costs (MTC) for providing their services, which falls between the values of the above ranges.

Functional profile of Natyra Albania based on local documentation.

Natyra Albania is a limited risk distributor, which performs simple functions and bears limited risk.

AUDIT FINDINGS

Audit Operations Performed.

- In order to assess the arm's length nature of transactions between Natyra Cosmetics companies, the auditors performed the following operations:
- analysis of local documentation submitted
- request for additional documentation and information.
- analysis of additional documentation submitted.
- interviews of Natyra Cosmetics personnel

For a more detailed description of the audit activities performed and the required documentation, please refer to the Daily Reports (as per annexes)

The tables below show the results of Natyra Albania in the years 2020 to 2024.

EUR 2024 EUR 2023 EUR 2022 EUR 2021

Revenues 2,468,079.54 2,205,712.64 2,221,543.41 1,957,079.69

COGS 1,286,187.20 1,117,954.02 746,351.30 837,796.41

Others costs 1,469,541.15 1,204,488.06 1,249,362.79 1,391,807.89

Ebit - 287,648.81 - 116,729.44 225,829.33 - 272,524.60

Net Finance result 11,656.15 18,103.64 12,845.41 89.69

Profit or loss before taxes - 299,304.96 - 134,833.08 212,983.92 - 272,434.91

Taxes 399.37 337.24 5,895.64 12,755.06

Profit /loss after tax - 299,704.33 - 135,170.33 207,088.28 - 285,189.96

Based on the audit operations carried out, it was found that Natyra Albania is a distributor of Natyra Cosmetics products in the Albanian territory. It employs 7 employees, in addition to 3 employees hired from a third party, the company Drini P&P Albania. Natyra Albania purchases goods from Natyra Romania and distributes them to sales agents or directly to consumers using Albanian Posta.

In particular, A.K. Sales Manager and E. S., Transport Manager, underlined that orders can be placed both by sales agents and by consumers. Sales agents place orders using specific software provided by Poland, while final consumers place orders using their personal account on the Natyra Albania website.

"Natyra Romania" receives the orders, prepares and distributes the boxes. "Albanian Posta" receives the boxes at the Albanian border and carries out the distribution. It also collects money from customers and then transfers the collected money to "Natyra Albania". "NatyraAlbania" pays "Natyra Romania" for the goods purchased, pays the sales agents for the sales services provided, as well as the postage for the service performed (see annex). The board of directors of the parent company makes all important decisions of "Natyra Albania"

- sales policy; direct sales methods
- pricing policy; affiliated companies decide on purchases and also on the selling prices of Natyra Albania
- transportation policies; affiliated companies decided that Natyra Albania should bear all transportation costs.
- policies on returned goods; affiliated companies decided that Natyra Albania should bear all transportation costs. Based on the statements of Natyra personnel, the Albanian company bears the risk for returned products
- Marketing policy; the affiliated companies decide the marketing and advertising budget, as well as which media should be selected.

During the interviews it was also found that "Natyra Albania" bears all transportation costs (from Romania to

the final destination), as well as costs associated with returned products. Consumers can claim to return products in cases of:

- Damaged Products
- Products that do not comply with the advertisement
- Delayed Deliveries.

The table below shows the above-mentioned costs of "Natyra Albania" in the years 2021 to 2024.

Nr Llogarie Emertimi i Llogarise	Eur 2014	Eur 2013	Eur 2012	Var % 12_14	Var%13_ 14
62201 Commissions expenses of Coordinators	243,875	211,070	156,191	56,14%	15,54%
6272 International Transport Expenses	82,547	59,925	70,517	17.06%	37.75%
6263 Postal & Storage Expenses	117,096	117,550	94,514	23.89%	-0.39%
70510 Returned Sales products	24,100	22,993	20,721	16.31%	4.81%

"Natyra Albania" also carries out marketing activities, customer support activities, training activities and research activities. These activities include:

- Support for customers who have problems when ordering online
- Translation Of brochures from English To Albanian
- Conducting market research and surveys
- Organizing Events
- Carrying out activities in the field of communication (mail notification)

The table below shows the main expenses related to the activities described above for the years 2022 to 2024

Nr Llogarie EmertimiiLlogarise Eur 2014 Eur 2013 Eur 2012 12_14 13_14

Administration Services (Loan Staff)

26,848					
21,595					
17,221					
55.90%					
24.33%					
62203 Sales Plan Commission	24,215	26,104	11,480	110.94%	-7.24%
62202 Fixed Commission ZM	23,255	22,736	30,508	-23.78%	2.28%
61109 Marketing Expenses	19,996	4,405	249	7917.83%	353.89%
65806 Representatives Expenses (Event)	N/d	19,915	31,092	25,405	-21.61% -35.95%
6182 Bussines Cost Expenses	17,143	15,000	2,691	537.05%	14.29%
62401 Advertising Expenses	12,867	2,234	100.00%	476.08%	
61107 Custom Services	12,344	8,331	5,835	111.56%	48.17%
64111 M.S	10,767				
64104 I .Salary	10,263	5,356	6,501	57.88%	91.62%
64103 E. Salary	9,644	9,163	8,768	9.99%	5.24%
64102 M. Salary	9,296	8,151	7,824	18.81%	14.05%
64108 K. Salary	8,290	7,799	7,347	12.83%	6.30%

In order to run its distribution business as efficiently as possible and to benefit from faster systems, "Natyra Albania" sh.p.k. purchases many IT support services and other support services from related companies.

Below we are reporting the amounts of related transactions identified through the analysis of the General Ledger of Accounts for the year 2024 provided by the company. In the summary record provided, some transactions are not linked to the name of the suppliers or they are described as IC records. For these reasons, it is not possible to identify the exact amount of IC transactions.

Accounts in which IC transactions are recorded.
 Supplier Type Euro
 Natyra Romani Purchase of goods 996,133.74
 Natyra Poloni Purchase of services 373,737.11
 Natyra Bulgari Purchase of services 37,606.58
 Natyra Serbi Purchase of services 27,248.25
 Natyra Hungari Purchase of services 6,529.70
 Natyra Macedoni Purchase of services 1,188.40
 Natyra EM. Poloni Purchase of services 54.9
 Natyra EM. Purchase of services 4.28
 IC Bookings Purchase of services 102,453.00
 Total 1,544,955.96

As a result of the audit operations carried out, it turned out that the services provided by the related companies are economically closely linked to the distribution activity. This is confirmed by the IC contract, interviews and the local documentation itself.

In particular, on page 1 of the contract between "Natyra Albania" sh.p.k. and Natyra Polonia it is quoted that "Natyra Albania"sh.p.k. "wants to use the certain management, functional and administrative services of those Service Departments to support the running of its business more effectively". "The use of Natyra services will improve the management of the functional area, the alignment with the Natyra Group guidelines, the adoption of best practices and the better coordination of the activity across Europe, the Middle East and Africa (EM).

According to the interviews conducted "the only activity of Natyra Albania is the distribution of Natyra Cosmetics.Co products in the Albanian territory". The services provided by the foreign affiliated companies, including Natyra Poland are closely related to the distribution activity". The local documentation itself refers to those services as "management support services" and "IT support services". In fact, they are intended to support the main activity of Natyra Albania, which is the distribution of "Natyra Cosmetics.Co" products.

The following table summarizes the results of "Natyra Albania" sh.p.k. in the years 2022 to 2024 and compares the cost trend between companies and third-party costs for the years 2022 to 2024. IC costs increased by 57.12% from 2022 to 2024, while revenues increased by 11.09% during the same period. Also costs (TP) with an increase of 37.12%, increased more than revenues for the period under review (IC costs).

2024	2023	2022	Var%_22_24
Total revenues	- 2,468,106.04	- 2,209,757.35	- 2,221,783.09 11.09%
Total Costs	2,766,440.06	2,344,590.44	2,008,799.17 37.72%
IC Costs	1,629,912.75	1,425,987.91	1,037,396.25 57.12%
TP Costs	1,136,527.31	918,602.53	971,402.92 17.00%
Profit/Loss	298,334.02	134,833.09	- 212,983.92

Functional profile of "Natyra Albania" sh.p.k. according to the auditors' findings The functional profile of "Natyra Albania" sh.p.k. that emerged as a result of the audit operations performed differs from the profile of a limited risk distributor, as described in the domestic documentation In particular, "Natyra Albania" was found to be a distributor, which performs simple distribution functions, but which bears more risk than a limited risk distributor. More specifically:

Returned product:

Every year "Natyra Albania" sh.p.k. bears the costs for returned products which are about 1% of the turnover. Returns can occur due to manufacturing defects, unsatisfactory products, or delays in delivery.

The contract between Natyra Romania and "Natyra Albania" sh.p.k. does not provide any limit on the costs

that can be borne by "Natyra Albania" sh.p.k in relation to these returns. This means that, potentially, in case there are many defects in the production, the cost per year could be even higher. For these reasons, we do not agree with the definition of "product liability risk" given in the domestic documentation which states that this risk should be considered rare.

In our opinion, a cost that occurs every year and that is potentially unlimited cannot be considered rare. In addition, we noted that this risk is linked to the production activities carried out by Natyra Poland, that is, it is a risk that "Natyra Albania" cannot control. This may also be in conflict with the arm's length principle. Indeed, with regard to the allocation of risks, the OECD Guidance notes that "in arm's length transactions, it makes sense to allocate to the parties a greater share of those risks over which they have more control".

In view of the above, Natyra Albania bears a product liability risk, which is neither limited nor rare.

Customer credit risk:

In 2024, the cost of debt cancellation represented 6% of turnover for the period 2024 (2,468,106.04 euros). Based on the documentation provided by the company, these costs are related to customer accounts booked in previous years. In 2024, it was found that these receivables could no longer be collected. For these reasons, we do not agree with the low level attributed to this risk in the domestic documentation. In our opinion, a cost representing 6% of turnover cannot in fact be considered "low". Critical remarks of the auditors on the transfer pricing analysis provided by the company. The audit operations carried out highlight the following critical issues in relation to the comparability analyses and the economic analyses described in the domestic documentation.

Comparability Analysis – Critical Issues

Review of the facts found by the Audit Company of "Natyra Albania" According to the local documentation, it is stated that "the facts found and the review efforts undertaken for this report include: - interviews and discussions with relevant personnel of Natyra Albania". We noted during the interview of the employees of Natyra Albania that they stated that they had never conducted any interview with the consultants of Audit Company XX, or in general, any interview for transfer pricing purposes. In relation to this review, the consultants responded that they had interviewed the managers of "Natyra Bulgaria" who are also responsible for the actions of "Natyra Albania" sh.p.k., as indicated by the organizational chart appearing in the local documentation.

Risk analysis

Regarding product liability, the local documentation states that: "when the return is made due to a manufacturing defect, the manufacturing subsidiary bears the risks associated with the return of the product".

We noted that, contrary to this, the personnel of "Natyra Albania" sh.p.k. claimed that "Natyra Albania" sh.p.k. bears all costs related to returned products, including products with manufacturing defects (interviews with personnel).

The Audit Company responded that the "Natyra Cosmetics" CO Group guarantees a full refund to its customers if they do not like a purchased product. "Natyra Albania" sh.p.k. bears only these types of costs. In fact, the costs for returned products with manufacturing defects are borne by the related manufacturing companies.

The Control Inspectors found that it was not possible to assess whether the statement of the consultants of the Audit Company was true or not, because the company did not provide the financial information of the related companies requested by the auditors.

FALSENESSES FOUND

ECONOMIC ANALYSIS – CRITICAL ISSUES

Calculation of the operating margin of the distribution activity

According to the local documentation, in 2024 the Operating Margin of the distribution activity was 1.69%. Based on the fact that in 2024 "Natyra Albania" sh.p.k. generated losses,

the auditors requested a description of the calculation process followed in order to achieve such a positive result.

The company underlined that the calculation presented in the local documentation was incorrect, as it did not include employee costs and depreciation costs. According to the new calculation, the Operating Margin resulted in -3.23%.

Critical remarks on the criteria used – independent parties criterion

The domestic documentation states that "To ensure that the companies identified through this search strategy are independent.

The Audit Firm of Natyra Albania used the automatic independence criterion of the Amadeus data program "selection by shareholder characteristics" to exclude companies with at least one shareholder that was a banking, financial institution, insurance or industrial company, private equity, public authority, pension or mutual fund, nominee, trust, authorized trustee, state, government, foundation or research institute. Another independence criterion that was applied was such that companies owned by more than 25% of the ownership shares were excluded.

In addition to the ownership criterion, the Audit Firm also applied a criterion for eliminating companies from the group if they owned subsidiaries. Although, in general, comparability cannot be affected if a company owns subsidiaries that perform the same functions and activities, this step has been added due to limited information that could allow deviations in the functional profile of each subsidiary.

In our opinion, the selected criteria are contrary to the framework of Albanian legislation because companies that are considered independent according to the legal framework of the legislation in question have been excluded.

In accordance with the Albanian Legislation "On Transfer Pricing", a person is considered to "effectively control the business decisions of another person", if the first aforementioned person:

- a) holds, or can control, 50% or more of the voting rights of the other person, which is a legal person;
 - b) Has the right to share 50% or more of the profits of the other person;
- Therefore, the research has also excluded companies owned by shareholders with a capital ownership ranging from 25% to 49.9%, which according to the aforementioned guideline, are considered independent.

By excluding companies that could be potentially comparable to "Natyra Albania" sh.p.k., the applied research is not considered reliable, and therefore, cannot be accepted.
Critical remarks on the criteria applied – Geographical location criterion.

EY has selected the following countries: Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom (see annex 1, local documentation 98).

In our opinion, the economic circumstances of Germany, Finland, Luxembourg and many other selected markets are not comparable to the economic circumstances of the Balkan market. The main differences include, but are not limited to (i) the fact that European countries have consolidated markets, while Balkan countries have emerging markets, (ii) GDP per capita. These differences may affect the business strategies adopted by companies and consequently the comparability.

Critical remarks on the applied criteria – Selection of industry code.
The main industry codes selected were: Wholesale of perfumes, cosmetics, wholesale of pharmaceutical goods.

The majority of the selected companies are distributors of pharmaceuticals. In the auditors' opinion there are differences between pharmaceuticals and cosmetic products that may affect the reliability of the comparability.

- There may be pressure on prices in the pharmaceutical market, as buyers of medicines are usually

large buyers (such as hospitals).

- In many countries governments bear the cost of medicines.
- In many countries, governments can limit the profits of pharmaceutical companies or set price caps.
- Drug distributors can also perform regulatory services
- Drug suppliers must be able to provide products regardless of any problems that arise. Therefore, they perform very efficient logistical functions.
- Marketing and advertising in the pharmaceutical industry are strictly regulated.

All the changes described above may affect comparability with the cosmetics industry. Therefore, a group of pharmaceutical companies is not reliable for the purpose of assessing the "arm's length" nature of the transfer pricing of "Avon Albania" sh.p.k. Critical observations on the Research conducted by the Audit Firm for the group of accepted companies.

Although the adopted criteria lead to results that, for the reasons mentioned above, cannot be accepted by the Albanian authorities, the Inspectors also analyzed all the accepted companies with the aim of proving the reliability of the local documentation provided by "Natyra Albania" sh.p.k. For this purpose, the auditors requested the extract of excel file obtained from the "Amadeus" program in order to verify the analysis carried out by the Audit Company.

Critical issues identified by the auditors for each of the companies accepted.

- Beta Company Greece: This company distributes pharmaceutical products, but also has specific storage services
- CRM Alpha x Company has one shareholder who owns the majority of the shares.
- E.Mandilis Company Greece owns 99% of the capital. It also provides specific storage services.
- O.T.farmaceutik (Poland) 100% controlled subsidiary
- F.S. Pharmalus.a (Greece) Shareholder with ownership of 80%
- R.Cosmetics (holdings) U.K The company controls 8 subsidiaries.

In the documentation filed by the company, it is claimed that "an independence criterion was applied in such a way that companies owned by shareholders with a shareholding of 25% or more were excluded". However, based on the critical issues we have indicated, 4 companies out of 7 are majority owned, and 2 out of 7 companies have subsidiaries with ownership percentages higher than 25%.

In conclusion, it appears that the company has not only selected the wrong criteria, but also has not correctly applied the wrongly selected criteria. For the reasons mentioned above, the research conducted by the company should not be accepted in full.

Additional critical remarks on the research conducted by the Audit Company on the testing of transactions for support services.

The two main controlled transactions under examination relate to the purchase of goods from "Natyra Romania" and the provision of support services by other related companies (mainly from Natyra Poland).

As highlighted above (see paragraph 2.1, "Audit operations performed"), these transactions are economically closely linked and cannot be assessed separately. Indeed, according to the OECD Guidelines: "there are often situations where separate transactions are so closely linked that they cannot be fairly assessed as separate.

Indeed, the company included in the calculation of the operating margin of the distribution activity (- 3.23) the cost of services provided by related companies. Following this, it seems inappropriate to test the transactions of regional support services separately from the purchases of goods.

In addition, the research carried out also has the following defects;

- Nature Poland cannot be selected as the tested party, because it is not the company with the least

complex functional profile. The tested party “will usually be the party that has the least complex functions in relation to the controlled transactions and does not contribute any intangible assets of value.” In the case under review, the parties to the transaction are Natyra Poland and Natyra Albania. Natyra Poland is a manufacturer, a distributor and a provider of IT services. Its turnover is more than 500 million euros and it has more than 2500 employees. Natyra Albania is a simple distributor. It has a turnover of about 2 million euros and employs 7 employees. It is quite clear that, in the case under review, the party that has the least complex functional profile is Natyra Albania.

- The company did not submit the information requested by the auditors regarding the related foreign companies. Thus, based on paragraph 10.3 of Instruction no. 16 dated 18.06.2014, the related foreign companies cannot be accepted as a tested party. Based on the critical issues described above, it is the opinion of the Control Inspectors that the searches conducted by the company should not be accepted.

Questions (relating to the case)

Summary of auditors’ findings and critical issues identified.

- 1) Natyra Albania sh.p.k is a distributor of “Natyra Cosmetics”CO products, which performs simple distribution functions and bears more risk than a distributor with limited risk.
- 2) In 2024, the operating margin of the distribution activity was -3.23%.
- 3) The economic analysis of the distribution activity performed by the company has many flaws and leads to results that cannot be considered reliable by the Albanian Tax Authorities
- 4) Since the purchase of goods and the provision of services are economically closely linked, they should be combined for the purpose of a transfer pricing analysis. For this reason, also the separate economic analysis regarding the provision of regional services should be rejected.

Proposed solution

New economic analysis performed by the auditors.

For the reasons described in the paragraphs above, the Control Inspectors conducted another economic analysis in order to identify independent distributors of cosmetic products, which perform similar functions and operate in comparable circumstances to those of Natyra Albania. For this purpose, the auditors conducted a search with the help of the orbis data program. The steps are described below:

Method Used

TNMM was applied to assess whether the profile of Natyra Albania was “arm’s length” or not. The operating margin was chosen as an indicator of the level of profit.

Tested party

“Natyra Albania” was chosen as the tested party, because it has the least complex profile for the transactions being examined.

Automatic Criterion.

Status: All active companies with unknown status.

Industry code: 4645 – wholesale of perfumes and cosmetics, 4646 – wholesale of pharmaceutical products, 4648 – wholesale of watches and jewellery, 4675 – wholesale of chemical products, 4778 – other retail sale of new goods in specialized stores, 4791 – retail sale via mail order houses or via the Internet.

Location: Balkan Countries.

Financial data – EBIT; all companies with a known value, 2023,2022,2021, for all selected periods, excluding companies without financial data and Public Authorities/States/Governments.

Financial data:

Turnover; 2023,2022,2021, min=1000, max=20,000, for all selected periods, excluding companies without

financial data and Public Authorities/States/Governments. Independence criterion – shareholder; companies owned by at least one shareholder; from one of the following types; Banks and Financial Companies, Insurance Companies, Industrial Companies, Private Equity Firms, Fund Managers, Venture Capital, Pension Funds/ nominees/trusts/trustees, foundations/research institutes, Public Authorities, States, Governments, one or more nominees of individuals or families, Employees/Managers/Directors, owning between 50% and 100%.

Independence criterion – subsidiary;

Companies that own at least one subsidiary; owned at least 50% and 100% or with an unknown %.

Losses: companies with two or more consecutive years of operating losses are eliminated.

As a result of the automated search performed, 268 companies were identified.

Quality Criterion

Different functions.

Companies that perform non-comparable functions are excluded. This is the case of companies that own intangible assets (brands) or that perform additional functions such as logistics services or registration services.

Different products or services;

Since it was possible to identify an acceptable number of companies engaged in the distribution of cosmetic products, companies distributing non-cosmetic products or other products were excluded for the reasons explained above.

Potential related party transactions:

As a result of an online review, when the possibility of a group link was identified, the company was excluded.

As a result of the qualitative examination, a number of 6 comparable companies engaged in the activity of distributing cosmetic products in the Balkan region were identified.

Financial Analysis

Several years were used.

Financial data from several years were used to assess the performance of these companies over time and to control for any deviation in the results of a single year. For this purpose, the years 2020 -2023 were selected to test the year 2024.

Profit level indicator

The operating margin was chosen as the most appropriate indicator of the level of profit to assess the “arm’s length” profile of the transactions under consideration. It is appropriate for a distribution activity, as it measures the relationship between profit and sales.

Range.

As a result of the process followed, the final group of companies has some comparability defects, which cannot be identified or adjusted. For example, since it was not possible to identify companies located in Albania, companies located in the Balkan countries were selected. Furthermore, although the website is available for all companies, limitations in the information available still remain and do not allow to identify exactly the functions performed by the selected companies.

In such a case, we note that the OECD Guidance suggests narrowing the range by using statistical tools, such as the interquartile range, in order to increase the reliability of the analysis.

Since the Albanian Transfer Pricing Law is based on the OECD Guidelines and the above-mentioned recommendation is not in conflict with the Albanian Income Tax Law, the interquartile range was considered as the “arm’s length” range.

Weighted Average

The weighted average on turnover was used to calculate the profit level indicator. Financial results of comparable companies.

Gama IQ

MIN 1.22%
IQ 1.87%
MED 3.59%
IIIQ 6.12%
MAX 7.86%

Conclusions - Assessment.

As a result of the audit operations performed and the analysis carried out by the auditors, the controlled transactions of "Natyra Albania" were not in accordance with the market principle. Based on the Albanian Legislation, since for the year 2024, the MO of the distribution activity (3.23) for "Natyra Albania" falls outside the market range identified above, the Control Inspectors made an assessment for the company's income tax.

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CASE STUDY 2- Armenia

Case Submitter:

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Background - Description of the Case:

A resident of the Republic of Armenia, "Company A", which is a 100% foreign-owned Universal Credit Organization (UCO), is a member of the "MNE Co." multinational enterprise group. The group carries out investments in the real sector of the economy through two investment funds.

"Company B" is a fund and resident in Country B. During the 2024 reporting period, Company B provided loans totaling 1,755,787,399 AMD (USD 4,390,000) to "Company A" UCO CJSC under several agreements and tranches.

Out of the above-mentioned amount, Company A actually received **830,000,000 AMD (USD 2,075,000)**, while the remaining 925,787,399 AMD (USD 2,315,000) relates to a novation agreement, which includes an extension of the contractual maturity as well as a revision and capitalization of interest.

The loans were granted for a term of 1—2 years, with the possibility of extension up to 3 years. The total loan amount was 1,755,787,399 AMD (USD 4,390,000), with a net interest rate ranging from 22.00% to 23.00%,

corresponding to a gross annual interest rate of 24.44% to 25.56%.

For transfer pricing purposes, the Comparable Uncontrolled Price (CUP) method was selected.

The Company obtained the loan from a non-resident related party, taking into account the following circumstances.

In 2024, the Company applied to banks, credit organizations, and other legal entities operating in the Republic of Armenia (resident country) in order to attract financial resources. As a result, it was possible to obtain a maximum of **1,228,549,200 AMD (USD 3,072,000) in loans and borrowings (banks generally provided 50%-80% of the amount requested in the loan applications)** at an average annual interest rate of 13.41%.

Since it was not possible to attract additional funds from the local financial market necessary to ensure the Company's normal operations, "Company A" UCO CJSC turned to alternative sources of financing. Consequently, due to the inability to secure sufficient funding in the domestic market, the Company obtained financing from a non-resident related party.

As a result, Company B provided the required loans at annual interest rates ranging from 24.40% to 26.90%.

According to the resident company's transfer pricing documentation, the above-mentioned interest rates were calculated as follows:

Fund Financing Rate	7,50%	10,00%	a
Financing-related Costs	1,75%	1,75%	b
Management Fee	1,75%	1,75%	c
Yield Differential	6,35%	6,35%	d=e-I
10-Year Yield of German Funds	2,65%	2,65%	f
Average Yield of RA Government Bonds	9,00%	9,00%	e
Interest Rate Risk Premium	9,85%	9,85%	g=b+c+d
Commercial Margin	0,75%	1,25%	h
Size Risk Premium	3,05%	3,05%	i
Company-Specific Risk	6,00%	6,00%	j
Credit Risk Premium	9,80%	10,05%	k=h+i+j
Pre-Tax Lending Interest Rate	27,15%	29,90%	l=a+k+g
Tax Rate	10,00%	10,00%	m
After-Tax Lending Interest Rate	24,40%	26,90%	n=l*(1-m)
Interest Rate on the Loan Provided to the Company	24,44%	25,56%	

Questions (relating to the case)

- 1) What are your thoughts on this arrangement, is it credible?
- 2) Do you agree with the calculation of the interest rate?
- 3) How would you calculate the transaction's interest rate, what will you take into account?

Proposed solution

Based on the Company's financial statements, the tax authority conducted an assessment of the Company's credit rating for the year 2024, as a result of which the Company was assigned a CCC credit rating.

The Risk-Adjusted Discount Rate approach was applied, and the arm's length range was determined. Under this approach, the risk-free rate of return on investment for the lending entity is first calculated, after which comparability adjustments are performed.

As the risk-free rate of return, the medium-term yield on USD-denominated government bonds in 2024 was used, with the following average values based on the months in which the contracts were concluded: 13.65% in July, 12.53% in October, and 11.45% in November.

Subsequently, comparability adjustments were made. In particular, the country risk premium of Armenia and the currency risk premium for the Armenian dram were added.

Specifically, the country risk premium for Armenia amounted to 4.39% in the second half of 2024. The currency risk premium for the Armenian dram, calculated based on the difference between the yields of Armenian government dram-denominated bonds and the corresponding USD-denominated bonds, amounted to 2.58% in July, 3.13% in October, and 2.9% in November, depending on the months in which the contracts were concluded.

As a result, the arm's length interest rate range for the loan denominated in Armenian drams was determined to be 18.74%–20.62% (U.S. government bond yield + country risk premium + Armenian dram currency risk premium), with a median of 20.05%.

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CASE STUDY 3 - Austria

Case Submitter:

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Background - Description of the Case:

Restructuring Facts

A company (öGes) is the economic owner of trademark rights and production know-how in Austria and on the foreign market in A. In previous years, which are now time-barred, öGes generated sales for the market in A. There were representative offices there, which were converted into a sales company ("DiA") in previous years, with the customers being transferred. There was no more turnover in öGes throughout 2018. öGes performed the DEMPE functions for this IP (primarily marketing), which were gradually transferred to DiA. The process was apparently completed in 2018 (exact date cannot be determined). Under a contract dated June 2019, the IP of the market in A was transferred to DiA as of January 1, 2018, and the capital gain was also recognized for tax purposes in 2018. The contractually agreed sale receivable resulting from January 1, 2018, was

converted into a “retroactive” loan (3% interest). There was no interest income accrued in 2018. The loan was repaid in December 2020.

A DCF valuation was presented for the transferred IP. Earnings calculations were made on an annual basis for the period 2018-2022, followed by a terminal value (TV). First, the system profit of the market in A was calculated (EBIT basis) and then the value of the distribution company in A (DCF on TNMM benchmark 3.5% median as the relevant EBIT of the potential routine profit of the distribution company in A) was deducted from this. It is not (yet) clear whether a transfer of the customer base in previous years led to an exit tax.

- The WACC was calculated for the system profit exclusively on an equity basis after adding 3.7% as a “size premium,” resulting in an interest rate of 11%.
- The results for the routine remuneration of DiA were discounted at 7.5% (calculation of the interest rate complex to illogical...).
- A growth factor of 0.8% was applied for TV.
- The theoretical inflow date for the individual cash flows was set at mid-year.

Parameters	Value
Long-term growth rate	0.8%
Discount Rate (DR_OD)	11.0%
Discount Rate (DR_RI)	7.5%
Routine Return - Routine Operating Margin (OM_RI) [1]	3.5%

Period:		0.5	1.5	2.5	3.5	4.5	4.5	
in million Euro	Key	2018	2019	2020	2021	2022	Terminal Value	Total
Net Sales Value	a	17.0	17.5	18.1	18.6	19.1	285.9	
Cost of Goods Sold	b	(11.6)	(11.9)	(12.1)	(12.3)	(12.6)		
Margin after Conversion	c = a - b	5.3	5.6	6.0	6.3	6.5		
Operating Expenses	d	(3.0)	(3.1)	(3.2)	(3.3)	(3.4)		
Local Advertising		(0.7)	(0.7)	(0.8)	(0.8)	(0.8)		
Local Consumer promotion		(0.2)	(0.2)	(0.2)	(0.2)	(0.2)		
Other F&S		(0.4)	(0.4)	(0.4)	(0.4)	(0.5)		
Overheads		(1.7)	(1.8)	(1.8)	(1.9)	(1.9)		
Pre-Tax Operating Profit	e = c - d	2.4	2.5	2.7	3.0	3.1	30.2	
OM%		14.0%	14.5%	15.2%	16.1%	16.1%		
NPV (Pre-Tax Operating Profit)	f = NPV[e]	2.3	2.2	2.1	2.1	1.9	18.9	29.4
Less: Pre-Tax Routine Return under best realistic alternative [2]	g = (-a) * OM_RI	(0.59)	(0.61)	(0.63)	(0.65)	(0.67)	(10.00)	
NPV (Pre-Tax Routine Return)	h = NPV[g]	(0.57)	(0.55)	(0.53)	(0.50)	(0.48)	(7.21)	(9.8)
Buy-out Payment	i = f + h							19.6

Questions (relating to the case)

General:

1. Is the agreement retroactively permissible, or are the actual successive transfers of DEMPE functions decisive for the date?
2. Alternatively, should a license be charged (residual or “bare” trademark or know-how license?) or should interest income from the “retroactive” loan agreement be applied, particularly for 2018?

Are the following approaches acceptable for IP valuation?

1. Method of deducting routine profit from system profit?
2. Use of a TV? Alternatively, a different time period?
3. Use of a “size premium” in the discount rate?
4. Different discount rates for IP and “routine remuneration”?
5. The middle of the year was set as the theoretical inflow date (correct)?
6. How should taxes be applied (gross-up, tax amortization benefits/TAB)?

Proposed solution

General:

1. No, but effective transfer took place in 2018
2. Interest had been paid for 2018, booked in 2019

Are the following approaches acceptable for IP valuation?

1. In case of the division of purchase price yes, the net business string shall be valued separately (net) except the discount rate is identical (no difference)
2. Depends on facts and circumstances, business rather yes
3. According to Austrian board of valutors: no indication on the market – besides the group is large (implicit support anyhow)
4. Dependence of businesses rather the same, but higher risk of IP?!
5. Yes, logical standard
6. In case of one-sided approach minimum is tax gross up

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CASE STUDY 4 - Azerbaijan

Case Submitter:

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Background - Description of the Case:

Outlook of the Case

1. Background

The audit concerns a contractor operating in the non-ferrous metals extraction sector as part of a multinational group. The contractor holds a 30% participation interest under a special Investment Agreement signed with the Government. Under this framework, fiscal obligations arising from extraction operations are allocated to participating investors according to their respective interests.

The audit examines whether head office costs allocated to the contractor under the group's Global Cost Contribution Arrangement (GCCA) are deductible, and how the Investment Agreement's expense limitations interact with the applicable Double Tax Treaty.

2. Operational Profile

The contractor is among the group's leading entities by revenue, assets, and workforce. Its core functions include:

- Extraction and processing operations
- Production management
- Engineering and technical services
- Logistics and operational coordination

Strategic management and group-level planning are performed outside the jurisdiction. This operational profile is relevant to evaluating the economic basis for the GCCA cost allocation.

3. Legal Framework

The Investment Agreement constitutes a special contractual fiscal regime for mineral extraction. As *lex specialis*, its provisions govern the deductibility of expenses for participating investors and include an explicit cap on the deduction of administrative costs.

Article 7(3) — Double Tax Treaty

Article 7(3) of the DTT between Country A and Country B provides that a permanent establishment is entitled to deduct a reasonable allocation of executive and general administrative expenses incurred for the enterprise as a whole. The contractor invokes this provision to support the full deductibility of allocated head office costs. However, the Investment Agreement's *lex specialis* status means its expense limitations apply to the covered operations and are not displaced by the general treaty provision.

4. GCCA — Cost Allocation Issue

Under the GCCA, the group allocates approximately USD 100 million in annual global head office costs across its entities. The contractor was allocated USD 20 million. The taxpayer maintains that this allocation was derived using established internal methodologies reviewed by recognised audit firms.

The audit identified the following deficiencies in the documentation submitted:

- Allocation keys used to distribute global cost pools specified but disclosing of amounts and Weighting of cost drivers was not provided
- No reconciliation between global pools and regional allocations was provided
- Mathematical derivation of the allocation percentages was absent

5. Key Issues

The audit focuses on the following:

- Whether the contractor may rely on Article 7(3) of the DTT to deduct the full GCCA allocation, or whether the Investment Agreement's expense cap applies
- Whether the allocated amount is consistent with the contractor's economic footprint within the group

6. Tax Authority's Position

The tax authority concluded that the full deduction cannot be supported on two grounds: Legal Ground: The Investment Agreement operates as *lex specialis* and its administrative expense cap governs over the general treaty provision.

Economic Ground: Allocating 20% of global head office costs to an entity performing routine operational functions is economically disproportionate.

Questions (relating to the case)

Transfer Pricing Perspective

- 1) From a transfer pricing perspective, what evidence would you require in order to accept the allocation of global head office costs to the local entity?
- 2) Which allocation keys would you consider most appropriate in the mineral extraction sector (for example: revenue, assets, employees, production volume, or another driver)?

Benefit Test

- 1) How would you assess whether the local extraction entity actually benefits from the head office services?
- 2) What type of documentation would you expect to see to demonstrate the benefit test?

Economic Consistency

- 1) If the entity represents a relatively small share of the group's global revenue but receives a disproportionately large share of allocated costs, would this raise concerns under the arm's length principle?
- 2) How would you test whether the allocation is economically consistent with the group's global operations?

Possible Solutions

- 1) What steps would you recommend to support the deductibility of the expenses?

Tax Authority Approach

- 1) How would you approach this case? Would you:
 - strictly apply the deduction cap in the Investment Agreement
 - partially allow deductions based on transfer pricing evidence
 - request additional documentation before allowing deductions
 - rely on the treaty provisions and allow reasonable head-office costs
- 1) From the perspective of a Ministry of Finance or tax authority, which approach would you consider the most legally defensible and administratively practical, and why?
- 2) Are Head-Office Costs Real Services or Profit Shifting?
- 3) Do you believe these allocations usually reflect genuine services received by the local entity, or are they often mechanisms used to shift profits out of resource-rich jurisdictions?
- 4) What practical method would you apply?

Proposed solution

1. Taxpayer Submissions

During the audit, the taxpayer submitted the following materials regarding cost allocation:

- External consulting firm reports describing global cost categories and related projects
- Internal allocation reports referencing allocation drivers used within the group
- Representations that methodologies had been reviewed by recognized audit firms

These materials were insufficient to verify the specific allocation keys, numerical derivations, or cost pool reconciliations applied to the contractor. The documentation did not allow the tax authority to confirm whether the methodology met the arm's length standard.

2. Alternative Allocation Methodology

Given the insufficiency of the taxpayer's documentation, the tax authority considers new independent

allocation approaches based on the contractor's economic footprint within the group. The following three allocation keys were applied:

- Operating Expenditure (OPEX) — contractor OPEX as a share of total group OPEX
- Capital Expenditure (CAPEX) — contractor CAPEX as a share of total group CAPEX
- Workforce — contractor employee count as a share of total group employees

These indicators reflect the contractor's relative operational scale and resource utilization within the group, providing an objectively verifiable basis for approximating its share of centrally managed administrative costs.

Marking purposes.

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CASE STUDY 5 - Bulgaria

Case Submitter:

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Background - Description of the Case:

Company A (a local entity for tax purposes in country X, which is a member of the EU) is the ultimate parent company of the ABC group, which operates globally in the development, manufacture, sale, and after-sales service of wind turbines. Company A has subsidiaries in X and abroad.

ABC group's main customers are global and regional energy companies, independent power producers (IPPs), and developers—companies that develop and invest in wind farms. A wind energy project typically costs more than €15 million, which is a significant investment. In this regard, ABC, like its competitors, has a relatively small number of clients, but they are large in terms of the scale of their operations.

The competitive environment in the sector is characterized by high concentration, with the top five wind turbine manufacturers accounting for more than 50% of cumulative installed capacity. This concentration reflects the high level of capital and specialized knowledge required to participate in the industry, which are significant barriers to entry. Another factor faced by market participants is the reputation of established companies. Since wind turbines are expensive and highly specialized machines, buyers are very sensitive to the reputation of their supplier.

Wind and other renewable energy sources compete with traditional fossil fuels, with one of the determining factors in this regard being the reduction in the average cost of energy production – LCOE. LCOE is an indicator for the economic evaluation of an energy project and is calculated as the ratio between the discounted costs of financing, constructing, and operating the project throughout its entire life cycle and the discounted amount of electricity actually delivered during the same period.

Wind turbine manufacturers can be roughly divided into two segments: 1) low-cost manufacturers aiming to reduce initial capital costs (price/MW) and 2) premium manufacturers aiming to reduce LCOE, i.e., increase the total return on investment for the entire project life cycle.

ABC maintains long-term relationships with its customers thanks to its ability to provide the lowest LCOE and optimize long-term energy production. ABC continuously implements and integrates new technologies to create highly efficient products and services in an effort to reduce LCOE. Company A has developed the ability to analyze large data sets and forecast wind and weather conditions, enabling ABC's global service organization to optimize long-term production from the installed wind turbine base at reduced costs. ABC's technology, technical and theoretical knowledge in the field of service provision is managed by Company A. These are complementary and reinforcing factors for increasing the output power of wind turbines and reducing LCOE, and represent competitive advantages for ABC.

The ABC Group generates revenue from the sale/implementation of wind turbine power plant projects and the sale of service solutions for the subsequent maintenance of installed power plants. The two segments are highly integrated, with project sales including mandatory 2-year service, but most customers extend the service period to 10 years at the time of purchase.

The ABC Group operates within a matrix structure that includes:

- 7 organizational (functional) lines:
 - Technology and Service Solutions (TSS)
 - Manufacturing and Global Supply (M&GS)
 - Sales ("Global Sales")
 - Services ("Global Services")
 - Finance ("EVP Finance")
 - People and Culture ("P&C") and
 - Communication, Brand and Public Affairs ("Global Communications").

Activities are primarily carried out within line organizations; however, a number of key decisions are made in cross-organizational committees, with the Executive Committee as the final decision-making body. The main members of these committees are the management of Company A.

- Business units, which are usually categorized according to the organizational line in which their main activity falls:
 - **Company A** – according to the ABC Group's business model, Company A is the "main entrepreneur/principal" that manages and controls the entire global business. It is responsible for the overall development of wind turbines, including product development, processes, marketing, etc. Company A owns all intellectual property rights of the ABC group – wind turbine designs, manufacturing manuals and know-how, marketing intangible assets, technical service manuals, the Z system used to monitor and manage installed capacity, and other business technical and theoretical knowledge. Company A is responsible for managing the global supply chain, providing guarantees and financing to customers in connection with the installation of wind turbines, assisting with the technical specification of projects, and providing detailed service and maintenance instructions. Company A is directly involved in the processes of production, sales, and after-sales services;
 - **Company B** – a licensed manufacturer that is subject to taxation jointly with Company A. Company B plays a significant role in manufacturing and global supply (M&GS). It acquires certain intellectual property (IP) rights of ABC on the basis of licensing agreements with Company A and outsources the

production of wind turbine components (rotor baskets, propellers, and control devices) to production business units (PBUs);

- **Production Business Units (PBUs)** – contract component manufacturers. Company A is responsible for capacity planning and decides which PBU will manufacture components for a specific project. Key material suppliers for PBUs are subject to prior approval by the global sourcing department (M&GS). The manufacturing process is based on designs, molds, and technical specifications provided by Company A or Company B;
- **Centers for providing contractual services related to research and development (R&D);**
- **Regional centers** – assist Company A in adapting and implementing global strategies in their respective regions. Although there are certain differences between regions, regional activities generally include activities such as technical sales support, Z operations, legal support, business development support, safety and training, supply chain support, people and culture, etc., carried out based on instructions and guidance provided by Company A;
- **Sales Business Units (SBUs)** – with few exceptions, each local market is served by a separate SBU. SBUs perform standard sales, construction, installation, maintenance, and service activities. Company A is closely involved in all areas of SBU operations in order to: 1) achieve satisfactory profitability on wind turbine project and service agreements; 2) ensure that its products are promoted, installed, and maintained in a manner that achieves optimal energy production; and 3) manage the significant risks that exist in the business with respect to contract default risk, product risk, etc. SBUs purchase almost all resources, including wind turbines and spare parts, from other members of ABC.

SBUs are supported by regional centers on a daily basis. As a result, a significant proportion of SBU employees are engaged in service activities rather than sales or other ancillary activities, i.e., a large proportion of SBU employees are service employees, while only a smaller number of employees are sales employees.

The implementation of an energy project usually takes place through a public tender or through an invitation to a specific equipment supplier or a comprehensive project solution. Given that the main customers of the ABC group are global customers with whom it has established long-term relationships, and that sales are usually made through tender procedures, the SBU's commercial activities consist mainly of preparing a bid in accordance with Company A's instructions and assisting in retaining and servicing the relevant customer. Although the contracts for the sale of projects and service solutions are concluded between the SBU and the end customers, based on their functions, assets, and risks, the SBUs are characterized as service providers rather than traditional commercial companies.

In addition, SBUs have limited material stocks (spare parts) related to wind turbine maintenance. The components for wind turbine projects are manufactured to order and, once delivered to the relevant market, are not stored by SBUs for long periods of time. SBUs typically only take on very limited risks, such as warranty risks related to poor workmanship. All other risks are mitigated and effectively assumed by Company A.

Project supply chain for installation of power plants:

1. Wind turbine development

- Company A develops all wind turbine technologies within the Technology and Service Solutions (TSS) department and engages SBUs to sell the wind turbines in local markets.
- Company A develops the value proposition (total product solutions) for the ABC group.
- Company A receives standard R&D services from certain subsidiaries.

2. Wind turbine sales

- The SBU identifies wind turbine project opportunities, typically with the group's existing customers.
- The SBU works with customers to plan the wind farm specification and prepares project bids with the help of regional centers and Company A. Activities are based on Company A's guidelines and instructions, and bids are optimized using Company A's Z system. Prices and terms are approved by Company A.

- Company A provides performance guarantees if required by customers.

3. Procurement and manufacturing

- Company A and Company B coordinate the global supply chain, including selecting which PBUs will manufacture the relevant wind turbine components.
- Company A pre-approves suppliers of key manufacturing resources, and the PBUs procure the input resources.
- PBUs manufacture wind turbine components based on technical specifications provided by Company A and Company B.
- PBUs sell their products to Company B, which resells them to SBUs.

4. Construction and installation

- SBUs manage the construction of wind turbine projects with the assistance of regional centers based on guidance and technical assistance from Company A.
- External partners are typically engaged in site preparation, tower foundation construction, and cable laying.
- SBUs install, test, and calibrate wind turbines using special transport and installation equipment rented from related parties.
- Upon completion, the customer signs a handover certificate and the SBU transfers the project to the customer.

5. Operation and maintenance

- See the description of the service supply chain.
- 99.6% of projects are sold with service packages that include guarantees for electricity production.

Supply chain for maintenance services

1. Development of a portfolio of services

- Company A develops a portfolio of services within the Global Services department that are tailored to the different risk appetites of customers:

1/ on-demand service (no subscription fee),

2/ basic service (turbine performance is ensured through regular maintenance with the option of additional maintenance of the installation component),

3/ full service (turbine reliability is increased through expert planned and unplanned maintenance),

4/ guaranteed availability (a guarantee of electricity availability is offered at various agreed thresholds. The ABC group undertakes to make compensation payments in the event of low plant performance, e.g. in the event of low wind speeds).

The service packages provide customers with access to the Z system.

- The Global Services department at Company A is responsible for the overall management of the service organisation.

2. System Z

- Company A develops system Z, which is the core of the services offered.
- The monitoring centers using Z are operated by SBUs in the US, Spain, and India based on detailed instructions and under the guidance of the Global Services department at Company A.

3. Sale of service products

- SBUs sell service solutions together with wind turbine projects, expand existing service and spare parts contracts with the help of regional centers and based on Company A's guidelines and instructions. Pricing and terms follow global guidelines developed by Company A's Global Services department.
- The service solutions developed by Company A optimize power generation, reduce LCOE, and are very

attractive to customers.

- PBUs manufacture and sell spare parts to Company A, which resells them to SBUs.

4. *Operation and maintenance*

- The Global Services department provides detailed maintenance instructions and ensures training and certification of service personnel.
- SBUs perform services based on the technical manuals and instructions provided by the Global Services department. Site visits are minimized through the use of the Z system.

The Z system is an extremely important component of the turbine service offered by the ABC Group. Z provides 24-hour monitoring of all turbines. It is connected to sensors and software installed in each turbine, and the service team uses the system to monitor the current operation of the turbine. ABC performs online monitoring of most of its wind turbines. The data is used to develop new and existing maintenance programs for installed turbines, provide feedback to Company A for future product improvements, improve customer satisfaction, and reduce costs by increasing the time between on-site visits by SBU service teams.

In addition, the Z system is used to manage customer relations. Z is an online business tool through which Company A receives direct orders and information about customer requests. Through Z, customers can communicate with and receive support from third parties—service providers involved in forecasting daily wind speed, direction, and air density—to establish weather forecasting and wind energy trading models. The system allows customers to maximise renewable energy production and minimise wind turbine downtime in order to reduce LCOE. Z was developed by Company A's engineers and wind turbine specialists.

Although most of ABC Group's competitors offer some kind of wind turbine performance monitoring system, the scale and breadth of data collected by the Z system is unique and is considered a key differentiator between ABC Group and its competitors.

Description of controlled transactions and transfer pricing policy of the Group:

Company C is a Bulgarian resident for tax purposes, part of the ABC group, which according to the above description can be characterized as an SBU.

According to the intra-group agreement and transfer pricing documentation submitted, Company C participated in the following controlled transactions during various periods:

Licensing Transactions

Pursuant to an intra-group agreement, Company A grants worldwide licenses for intellectual property (inventions, patents, utility models, technology, designs, know-how, technical specifications, manuals, trademarks) respectively:

- to PBU – for the manufacture, marketing, import, export, sale, transport, repair, and replacement of the Products or parts thereof, and for the performance of all other actions that may be envisaged or permitted by Company A from time to time, with the right to grant sublicenses;
- to SBU – for marketing, import, export, sale, transport, installation, shipment, service, repair, and replacement of the Products (wind turbine components and spare parts) or parts thereof, and to perform all other actions that may be envisaged or permitted by Company A from time to time, with the right to grant sublicenses;
- to other members of the group (affiliates) – to perform all actions that are envisaged or permitted by Company A from time to time, with the right to grant sublicenses;
- For the use of intellectual property;
- PBU owes Company A royalties and license fees when a Product is invoiced to a subsidiary or external customer. The amount of royalties and license fees is determined annually for the following year. The interim rate for royalties and license fees should, as far as possible, correspond to the arm's length principle (ALP) and may be reviewed and adjusted by Company A on an ongoing basis.

- SBUs do not owe royalties and license fees, as these are included in the transfer prices determined when purchasing Products from PBU. Product transfer prices may be further adjusted at any time to ensure that SBUs are remunerated in accordance with the Arm's length principle (ALP).

Purchase and sale of components and spare parts

Under the intra-group agreement, transfer prices for components and spare parts are based on price lists for the following calendar year, which are approved in advance by the Global Finance department. Transfer prices are based on forecast costs for raw materials, labor, currency, interest, and other variable costs. During the current calendar year, transfer prices may be reviewed, adjusted, and applied to ensure that pricing at all times reflects errors or fluctuations in actual costs.

During the year and at the end of the year, the Global Finance Department assesses the remuneration of the subsidiaries to ensure that it complies with the ALP. For this purpose, comparative analyses are performed in accordance with the OECD Transfer Pricing Guidelines, on the basis of which adjustments may be made to transfer prices for transactions involving Products, IP licenses, services, etc.

According to the local file submitted by company C, SBUs typically purchase wind turbine components from PBU (most often company B) and spare parts from company A, which itself purchases them from PBU or external suppliers. The prices of components and, to a limited extent, spare parts are set to ensure that SBUs receive market remuneration for their sales and service functions.

The price of components is initially determined based on the cost price (e.g., raw material costs, labor costs, and other variable costs) of the component or the cost price plus a 30% markup specified in the global group price lists. Spare part prices are based on the price paid to external suppliers or the costs incurred by the PBU. No margin is added when spare parts are sold internally between ABC Group affiliates. Spare parts prices may be adjusted by Company A on an ongoing basis or at year-end to ensure market remuneration for the SBU.

Continuous Improvement Management (CIM) services (warranty costs)

Reliability is a key concern in ABC Group products as it affects LCOE. Company A invests significant resources in improving products and increasing the reliability of wind turbines. This work includes design, manufacturing, installation, and ongoing maintenance. Company A's CIM department, part of TSS, assumes responsibility and bears the risks associated with generic defects arising from errors in design, construction, or manufacturing guidelines/processes prepared by Company A, as well as generic defects related to the design, materials, and manufacturing of products supplied by internal and external suppliers.

Initial direct and indirect costs associated with CIM cases (excluding capacity and depreciation costs), including all dismantling and installation activities, all travel expenses, and all transportation costs, are incurred by the SBU but are subsequently transferred to Company A without a markup.

Purchase and sale of human resources

In order to make optimal use of human resources between the subsidiaries in the group, a practice has been established for hiring personnel in connection with the need for such personnel in the performance of specific construction and service activities. The hourly rates for these services are determined on the basis of the actual costs incurred by the subsidiary providing the personnel. No surcharge is applied. Company C receives and provides human resources.

Various intra-group services

The subsidiaries of the ABC group are involved in receiving and providing various intra-group services and reimbursing expenses. The price for these services is determined on the basis of the actual costs incurred, with a surcharge of 0% or 5% applied. According to the local file submitted, these transactions are limited in scope for Company C.

Aggregate assessment of transactions

Given the interrelated nature of the controlled transactions involving SBU in relation to Company C, an aggregate approach to assessment has been adopted for transfer pricing purposes. Furthermore, SBU's sales,

distribution, and services are not considered to be determining factors for the success of the ABC group. The success of the commercial operation is highly dependent on a number of factors, including the technology embedded in the products, the customization and design of the wind farm layout, which are managed by TSS in Company A. In this regard, the application of the the Transactional Net Margin Method (TNMM) test verifies whether Company C receives market compensation for the functions it performs, the assets it uses, and the risks it assumes. Based on a transfer pricing benchmark test, it has been determined that Company C (as the tested party) should achieve a return of 7%, calculated as the ratio between profit before tax (PBT) and its value-added costs (VAC) – mainly staff remuneration and operating expenses. The ratio is based on PBT because the SBU's financial income and expenses are highly integrated with its operating activities.

The transfer pricing benchmark test selected nine EU companies whose activities are related to the provision of technical services and the sale of equipment for electrical systems and installations. The financial indicator used is the weighted average return on operating expenses ("EBIT/OPEX") for three consecutive years – the Berry ratio. Operating expenses were calculated as the difference between all expenses of the respective company and "material cost" (depending on the accounting rules applied in different jurisdictions, "material cost" may include expenses for raw materials and supplies, electricity, cost of goods sold, etc.).

I. CONSIDERATIONS OF THE BULGARIAN TAX AUTHORITY

1. ABC Group's two business lines (manufacturing and sale of wind turbines (WTG) as well as provision of WTG maintenance services) are closely related and mutually complementary – it is clear that usually the conclusion of a service agreement is preceded by a previous WTG Component Sale Agreement. On the other hand, it cannot be excluded that customer preferences for the group's products are determined to some extent by the possibilities after the installation of the wind turbines to receive flexible and high-quality service solutions that are tailored to the individual needs of the customer and ensure an increase in the return on investment. Therefore, it can be argued that, in relation to the two business lines, the Group members are exposed to the same or closely related marketplace risks. On the other hand, the available information shows that the two business lines imply the use of different resources and the performance of different functions – the manufacturing of WTGs is highly capital and technology intensive, while the provision of WTG maintenance services requires effective cost control, including in relation to the optimal staffing of highly qualified and motivated on-site technicians. It follows that there is no overlap in all economically significant risks associated with the two business lines.
2. Although Company C does not participate in the development of service products, it takes part in the negotiations for the renewal of expired service contracts, assisting in the adaptation of these products according to the individual needs of customers, as it knows these needs best from daily communication with customers in solving their various technical problems. The Bulgarian company plans, organizes and performs its service operations by its own. It has the necessary materials, tools and qualified personnel, who daily carry out on-site visits and reporting in connection with scheduled and unscheduled maintenance services, which activities are essential for the execution of relevant contractual obligations to customers.

The available accounting information shows that Company C incurs costs for personnel, transport, consumables and spare parts, rental of tools, training and education, etc. On the other hand, no specific remuneration is foreseen for the maintenance programs developed by Company A.

The available information also does not give an accurate idea of the benefits that Company C derives from the access to the analyses provided by the Z system, for which no separate remuneration was determined either. No evidence is presented for the existence and main characteristics of these analyses including their uniqueness and potential to create additional value

in the provision of various service solutions.

According to the presented transfer pricing documentation (local file) in the period 2013-2015 Company C received long-term support from Company A and other members of the Group in connection with the implementation of the WTG maintenance services contracts, as well as services of a general administrative nature. However, the local file only contains information on services that could be qualified as low value-adding intra-group services.

In this regard, it should be noted that before 2012, as well as after 2015, Company C was also charged by Company A for management and administration services, which varied considerably from year to year (for example BGN 15 157 000 for 2009, BGN 0 for 2010, BGN 356 000 for 2011, BGN 606 000 for 2012, BGN 0 for 2013-2015, BGN 775 000 for 2016 and BGN 1 223 000 for 2017).

In view of the above and given the diversity in the conditions and circumstances of the service contracts performed by Company C, the available evidence does not contain sufficient information to reliably assess the value contribution of the individual members of the Group in the presented supply chain for ABC Group services

3. According to the local file Company C is subject to local economic conditions, changes in government regulations, and fluctuations in consumer demand, which can impact customers incentive to purchase wind turbines and components as well as Company C's ability to generate revenue. Although the Bulgarian company initially bears market risks, due to the transfer pricing policies involving Company C's purchases of WTGs, any costs initially incurred by Company C related to this risk are effectively borne by Company A. Therefore, Company C's market risk is minimal. Similar conclusions are drawn regarding other risks to which the Bulgarian company is exposed – in particular, inventory, warranty and product liability risks.

As stated above, the economically significant risks associated with ABC Group's two business lines differ. In the period 2013 – 2015 Company C did not participate in new projects and its staff was mainly engaged in providing maintenance services to third party customers. In this regard, it is incorrect to assess the significance of the risks to which the Bulgarian company is exposed in connection with its activity by comparing them with other risks to which the Group as a whole is exposed, arising from activities that Company C did not carry out in the period under consideration.

The contractual allocation of responsibilities between the various members of the ABC Group for the performance of the WTG maintenance services is different from that of the WTG Sales. First of all, as mentioned above, the performance of the two types of activities implies the assumption of different economically significant risks. Secondly, from the content of the presented Internal Group Agreement (IGA) it is clear that the responsibilities for the successful WTG sale are largely transferred from the SBU to other members of the ABC Group, which are engaged in the design, manufacture and supply of the relevant WTG components. On the other hand, from the provisions of the same IGA, it cannot be judged that certain risks, directly related to the servicing of the already installed WTGs are transferred unconditionally to another company and accordingly are not borne by Company C.

The transfer pricing policy adopted by ABC Group, in which the Bulgarian company is remunerated with a relatively low (but stable) return, in itself is not sufficiently indicative of the risk profile of Company C.

The understanding of the Bulgarian tax authority is that, in addition to the risk associated with the timely and qualitative performance of contractual obligations, another economically significant risk

arising from the service contracts (especially long-term service contracts) is the extent to which the initially agreed flat fees will cover the actual costs of providing the services. In this regard, it is true that the Bulgarian company receives support from other members of the Group in connection with the negotiation of the prices and other terms of the service contracts, but the subsequent contract implementation activities and the resulting costs are entirely under the control of Company C. Although the employees of the Bulgarian company rely on the technical manuals and data provided by Company A and the Z system, there is no reason to believe that it is not them, but someone else, who takes on a daily basis the important decisions related to the planning, organization and execution of the relevant service activities, the provision of spare parts and consumables, the quality control, etc.

In addition, as can be seen from the presented changes in the revenue structure of Company C, the company is exposed to a significant market risk, to the control of which it undoubtedly contributes both in the course of daily contacts with its customers and through its participation in the negotiations for renewal of the initial service contracts.

Based on the data from the annual financial statements of Company C, Bulgarian tax authority considers that the company has the necessary financial capacity to assume the identified economically significant risks associated with the provision of WTG maintenance services.

4. In accordance with ABC Group transfer pricing policy an aggregated approach is adopted for testing the controlled transactions with the participation of Company C. In this regard, as a profit level indicator (PLI) is selected the ratio of profit before tax (PBT) of the Bulgarian company to its value adding costs (VAC). The ratio is based on PBT as SBUs financial costs are highly integrated with its operational activities and also the SBUs should not incur foreign exchange effects related to invoicing in different currencies. Risks related to such fluctuations are mitigated by basing the ratio on profits before taxes.

VAC, which mainly includes salary costs and operating expenses, are defined based on general ledger account numbers used in the ABC financial reporting system. As a result, all costs that are classified as cost of goods sold (COGS) in accordance with the applicable accounting rules are excluded from the cost base, i.e. are not treated as VAC, but as pass-through costs. However, the understanding of the Bulgarian tax authority is that this approach is not correct, because although it prevents some comparability issues, the selected denominator is not fully consistent with the functional analysis of the controlled transaction, and in particular with the allocation of risks between the parties. For example, COGS includes costs related to consumables, transport, rental and exploitation of tools and other equipment, directly related to the services provided, in relation to which Company C is not acting only as an agent or intermediary.

It should also be noted, that ABC Group justified the choice of PLI on the fact that WTG components have a much higher unit value than other goods, so including them in the cost base would obscure the actual value contribution of the Bulgarian company. However, in the period 2013 – 2015 the main sources of revenues for Company C were different from these in the previous periods and especially in 2014 – 2015 the company's costs related to components represent a much smaller portion of all its costs, which is consistent with the fact that after 2012 the Bulgarian taxpayer no longer participated in WTG construction and installation projects.

In addition, the Bulgarian company is not charged for some of the services provided to it by related parties (management and administration support), as well as for the provided technical manuals and the Z system data and analyses, which raises doubts that in this way it is aimed a reduction of the cost base on which the mark up is calculated. It is also true, however, that the denominator should be reasonably independent from controlled transactions.

Given the above, the PLI used is not the most appropriate in the case under consideration.

5. In the considered period, Company C generated revenues from various heterogeneous sources, which were not constant in individual years, neither as absolute values nor as relative weights in the total revenues. According to §2.84-2.85 and §3.10-3.11 OECD TPG, it would be inappropriate to apply the transactional net margin method on a company-wide basis if the company engages in a variety of different controlled transactions that have different economic logic and cannot be appropriately compared on an aggregate basis with those of an independent enterprise. In this regard, some of the controlled transactions with the participation of Company C – sale of spare parts, sale of CIM costs and sale of manpower, could be reliably evaluated on a separate basis.

Questions (relating to the case)

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Proposed solution:

1. Given the considerations detailed in the presented transfer pricing documentation, the Transactional Net Margin Method (TNMM) can be accepted as the most appropriate transfer pricing method, with Company C being the tested party.
2. The aggregated approach should also be maintained in respect to the transactions that cannot be reliably evaluated on a separate basis. In this regard, in order to improve the analysis, the following transactions should not be covered by the aggregated approach:
 - Revenues from sale of WTG components which derive from transactions with related parties, carried out as a result of the decision of the Bulgarian company to terminate its participation in new WTG projects and, accordingly, to sell all WTG components available in stock. These amounts should be treated as non-recurring items, which should not result in profit or loss.
 - Revenues from related party transaction services which derive from sale of CIM costs and sale of manpower. The sale of manpower could be qualified as low value-adding intra-group services according to Section D of Chapter VII of the OECD TPG. Although the CIM services probably do not have all the characteristics of low value-adding intra-group services, for practical reasons they can also be considered as such. Therefore, the revenue from these controlled transactions should result in an additional profit for the Bulgarian company in the amount of 5% of the costs incurred.

The rest of the revenues of Company C derive mainly from the provision of various types of services to third parties, which can be evaluated on an aggregated basis.

3. The PLI used by Company C to test the arm's length result of the controlled transactions on an aggregated basis is not appropriate. Therefore, the denominator in the PLI to be replaced by the revenue from the transactions under consideration, i.e. the PBT of Company C to be weighted against sales. Although cost-based indicators are commonly used in services cases, the proposed PLI is more appropriate because, unlike costs:
 - sales can be measured in a more reliable and consistent manner;
 - sales are independent from controlled transactions;
 - sales reflect the customer-facing functions of the Bulgarian company and its contribution to the control of marketplace risks.

IOTA Case Study Workshop “Advanced Transfer Pricing Issues”

29 - 30 April 2026
Budapest, Hungary

CASE STUDY 6 – Czech Republic

Case Submitter:

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Background - Description of the Case:

- MAP application filed under the DRM Act
- Relates to a change in the functional and risk profile of a tax entity - a subsidiary, in this case an increase in the profile from LRE to FFE
- Relates to the valuation of restructuring costs that were not charged to the subsidiary
- The parent company carried out a restructuring in **2019** for the purpose of optimization, when it expected a decrease in production volume. Based on the management decision, it transferred Know How and production to a foreign subsidiary. The functional and risk model of the parent company was downgraded to Low Risk Entity (**LRE**), while the functional and risk profile of the subsidiary was increased to Fully Fledge Entity (**FFE**).
- Based on a tax audit of the parent company, a foreign tax administration issued an assessment, finding that no corresponding costs had been re-accounted for the subsidiary in the previous 5 years. The corresponding costs are the costs incurred in preparing and implementing the restructuring.
- After 5 years, it was decided to discontinue production at the subsidiary without compensation.
- The economic results of the tax entity and an overview of the restructuring costs, together with the proposed adjustment, are presented in the following tables.
- Note the total values of the adjustment, I'll come back to them later.

Costs description	CZK million
Transfer of Aftermarket Business	15
Support / Project management	9
Legal Support	8
Exces Facility Costs	5
Waranty	7
Project Disruption	8
ERP System	14

Other Assets	15
Inventory	12
Project on Hold	4
	97

	2016	2017	2018	2019	2020	2021	2022	2023	2024
Sales	1 293	1 265	1 560	1 373	1 461	1 231	1 138	1 209	1 342
Costs	1 218	1 247	1 530	1 345	1 325	1 193	1 089	1 194	1 216
Operating result	75	18	30	27	136	38	49	14	126
EBIT	74	25	17	29	122	27	47	17	112

Questions (relating to the case)

Proposed solution

Tax administration position description

- Firstly, it is necessary to assess whether the costs are tax-efficient
- Then it is necessary to consider whether the costs meet the Arm's Length Principle and the Benefit Test.
- Then it is necessary to assess the amount of the costs to which the dispute relates in relation to the company's economic results.
- It is also necessary to assess the impact of the change in the functional and risk profile of the subsidiary. The increase had no significant impact on the entity's finances!
- Based on the investigation, it was found that the decision to restructure the parent and transfer production to the subsidiary was made by the parent company.
- The costs of restructuring were assessed, the costs of transferring production (to the company) were assessed separately, and the costs of carrying out the restructuring were separately assessed
- The impact of the restructuring on the subsidiary was assessed, the turnover is essentially the same, the profit fluctuates significantly over the next 4 years.
- The costs of preparing and implementing the restructuring were assessed in relation to the Arm's Length Principle and the Benefit test, a request was sent to the tax entity for a breakdown of the calculation and documentation of their amount.

- The costs of valuing the company, which also included the Exit Charge, were checked in relation to their valuation, here taking into account the prediction of economic development.
- The resulting position will also take into account the level and quality of the prepared documents. The MAP application has not yet been completed,
- The position of the Czech tax administration has not yet been determined.

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CASE STUDY 7 – Denmark

Case Submitter:

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Organization: The Danish Customs and Tax Administration

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Background - Description of the Case:

The case involves a Danish entrepreneur and principal of a global Group involved with production and sale of construction products with a well-known brand and good quality. The Group acquired a German production and sales company primarily because of a different product technology than the rest of the products in the Group. After the acquisition the German company continues to sell products under the German brand in Germany whereas others are sold under the Groups name. The two products are relatively alike but there are differences relating to color, design, control system and the brand under which the products are sold.

R&D functions are performed by both the German entity and the Danish principal. Over the past years improvements are implemented in the German products first and then later in Group products.

The Danish principal has 3 significant controlled transactions with the German entity:

- The German entity receives administrative services from the Danish principal, cost +5%
- The German entity pays a technology fee for access to the Group technology IP owned by the Danish principal, 2% of revenue
- Group brand products produced by the German entity are sold to the Danish principal for further resale. Products are sold according to group reference prices with a TP-index of 100

Typically, the Danish principal buys products from productions companies and resell them to sales companies, ensuring a TNMM remuneration for both the production and sales companies.

As the German company has its own IP and sells products under a German brand this normal TNMM structure is not enforced, and the German company have had increasingly high EBIT margins in the latest years.

A segmented statement of the German margin revealed a higher margin for Group brand products than for the German brand products.

At the same time, it was identified that reselling the Group products have resulted in a gross loss for the Danish principal.

Questions (relating to the case)

- 1) Should we accept the Danish gross loss resulting from reselling the Group brand products?
- 2) Which type of IP is identified in the sale of Group products produced by the German entity?
- 3) Which functions does the German entity perform in the sale of Group products to the Danish principal and how is that different from the functions performed when selling the German products?
- 4) What would be the most appropriate TP method for the sale/purchase of Group brand products?

Proposed solution

The German entity has increasingly high margins whereas the Danish principal has losses with respect to purchase/sale of Group brand products. This is not accepted and must be adjusted for.

Different types of IP are identified in this case. The Group brand products are produced by the German entity with the related production IP and sold with Group brand (brand IP) and with a different control system (combined product technology IP).

When both parties in a transaction make unique and valuable contributions the profit split method can be the most appropriate TP method.

The German entity is fully fledged when selling the German brand products, entailing functions as production, sales, marketing and certain R&D. With respect to the Group brand products only production functions are performed by the German entity.

The case was resolved using a profit split method. Using the segmented statements of the German entity a residual profit for producing the German brand products was identified taking into consideration the routine functions (production/sale) earning a TNMM remuneration. The same residual profit ratio must be earned by the German entity by producing the Group brand products. The excess amount belongs to the Danish principal.

The case is still pending an MAP-solution.

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CASE STUDY 8 – France

Case Submitter:

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Background - Description of the Case:

Company X is a Georgian resident company, incorporated in 1998 and fully owned by a foreign parent

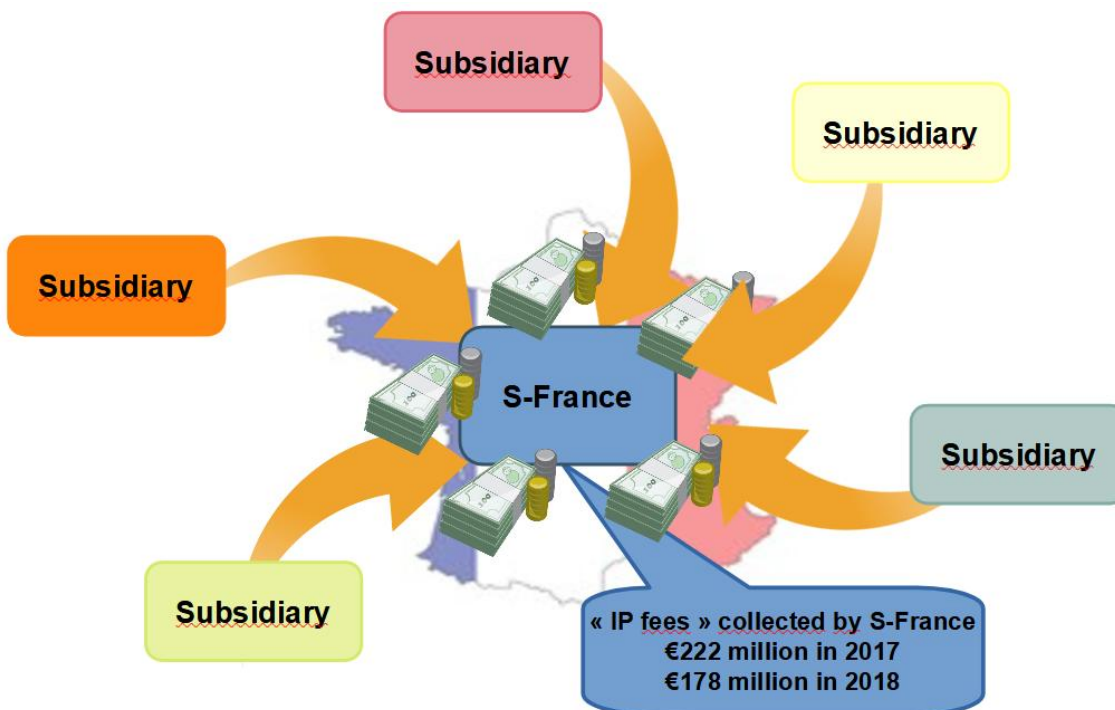
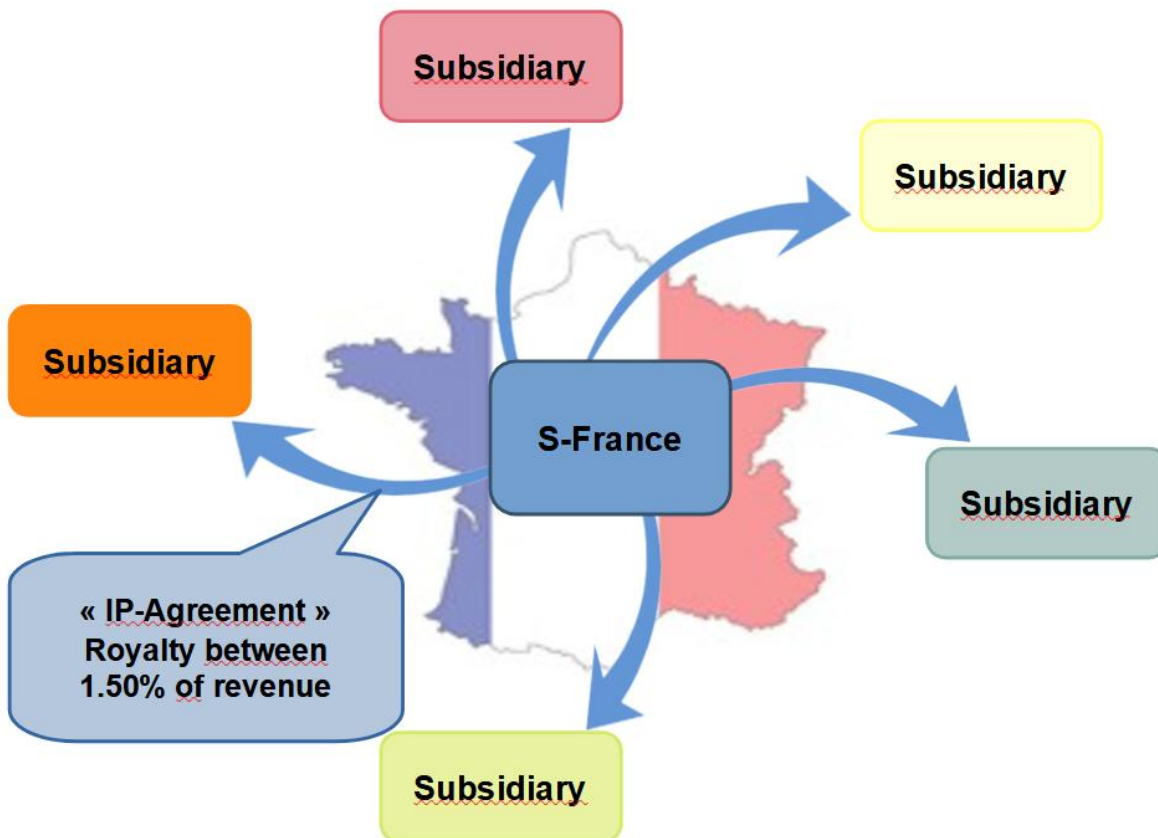
The audit relates to the company « S-France », which is the parent company of the « S-Group ».

S-France owns all intangible assets (trademarks, patents) (« IP »). S-France licenses these IPs to its subsidiaries under an intellectual property license agreement (« IP agreement »).

In return, S-France receives royalties at a rate of 1.5% of the subsidiaries' turnover, for a total amount of approximately €200 million per year.

The Group in figures :





Facts about the audit :

In 2020, the group reorganised its « IP fee » flows without altering the group’s structure. Four regional « Hubs » were identified : S-France, S-US, S-UK and S-Singapore.

The Group considers that these four « Hubs » centralise the Group's key and « strategic » operations at a global level.

The Group considers that the activities of the « Hubs » constitute DEMPE functions relating to the Group's IP.

S-France has given legal existence to the activities of the « Hubs » by signing a Business Research & Development Services agreement (« BR&D Agreement ») with the other three « Hubs » (S-US, S-UK and S-Singapore).

Extract of the services covered by the « BR&D Agreement»:

APPENDIX 1 NATURE OF THE WORKS

The Works may include the following (for the avoidance of doubt, this list is not exhaustive and may be reviewed from time to time as agreed by the Parties):

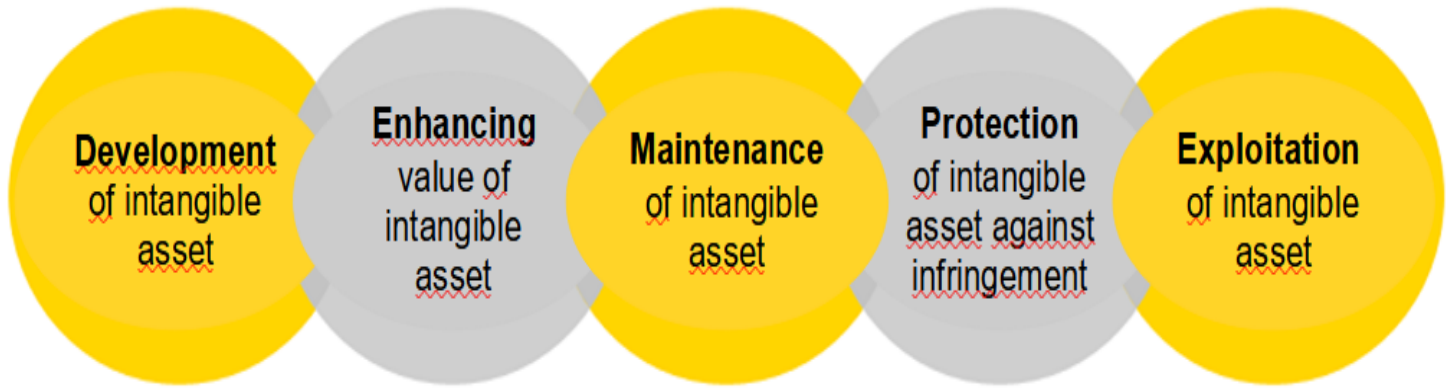
- **Development, enhancement, maintenance and protection of tools / processes** such as tools, systems, SOPs or procedures that contribute to the safe, efficient and innovative design and delivery of Quality of Life services (at predictable and competitive cost and quality).

This category includes for instance:

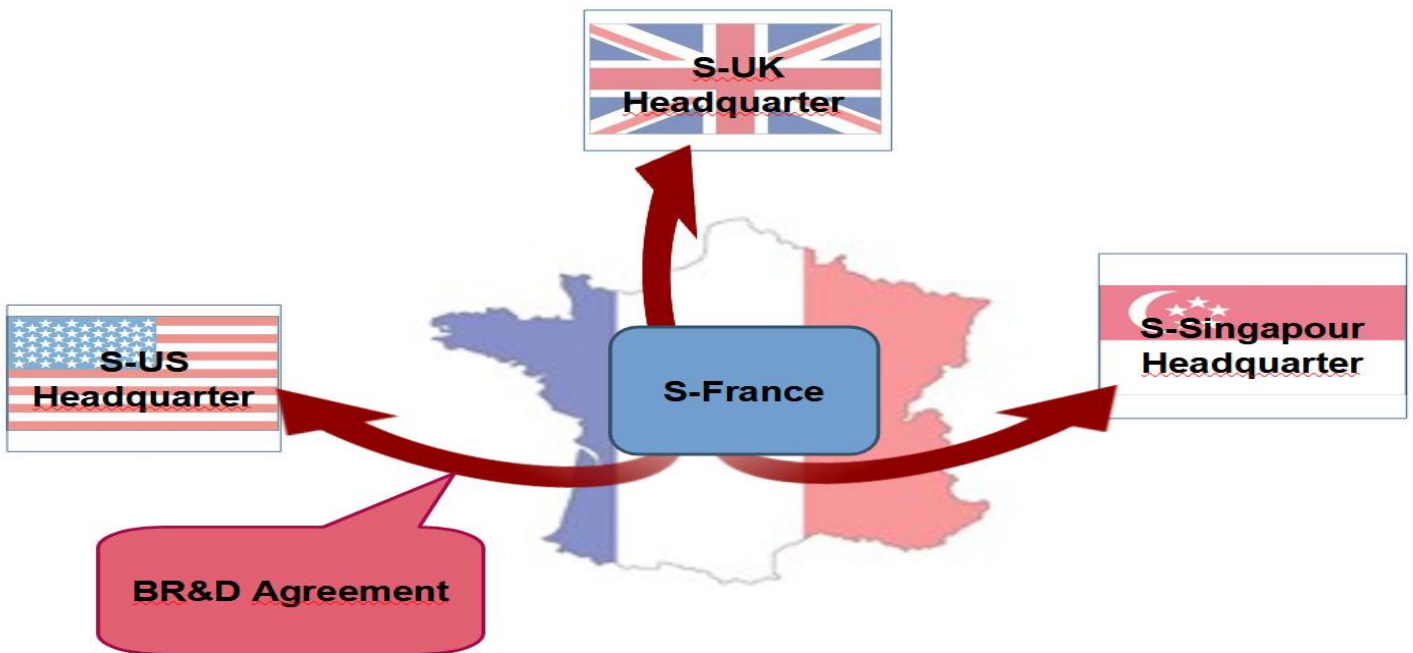
- o Best practices for process and methods (including for safety)
 - o Development of digital application or solutions
 - o Communication and digital guidelines
 - o Platform for digital know-how sharing
 - o Service Operation's financial tool and processes
- **Development, enhancement, maintenance and protection of marketing intangibles** such as innovative offers, Principal lists, Principal relationships, and Principal data that are used or aid in developing, marketing and selling services to clients;

DEMPE functions :

« Development, Enhancement, Maintenance, Protection and Exploitation »



The OECD, through BEPS Action 8, has established new guidelines for the identification and allocation of value generated by the exploitation of intangible assets and the resulting transfer pricing policy.



Facts about the audit :

In accordance with the DEMPE functions principle and the « BR&D Agreements », the Group considers that the Hubs contribute to the Development, Enhancement and Maintenance of the S-France's IP.

The « Hubs » charge S-France a fee known as « BR&D fees » for services provided under the « BR&D Agreements ».

The amount of the « BR&D fees » is determined by applying a residual profit split to the IP revenue received by S-France.

The determination au the « BR&D fees » is done in 2 steps :

1. **First Step** : Determination of the residual profit.
2. **Second Step** : Residual Profit allocation.

Facts about the audit:

- **First Step** : Determination of the residual profit.

To determine residual profit, S-France allocates a routine profit to the other Hubs for their Support and Consulting Services functions. The Hub's compensation was determined by using the TNMM method.

The company's residual profit is then determined by subtracting the regular remuneration of S-France's subsidiaries from the group's overall profit.

$$\text{Residual Profit} = (\text{Group's overall Profit}) - (\text{S-France Subsidiary Profit})$$

Facts about the audit :

- **Second Step** : Residual Profit allocation

The allocation profit key used is « Entrepreneurial Capital » (conceptual term that represents expenses related to IP), defined on the basis of 2 sub-steps :

1) Categorization of the Hubs' costs ;

2) Calculation of split factors.

Facts about the audit :

1) Categorization of the Hubs' costs

Using the RACI method, based on interviews with all Hub employees, the company determined the percentage of expenditure items to be included in the IP costs category for the purpose of calculating « Entrepreneurial capital ».

This percentage per department is based on the time each employee spent developing IPs.

	Categorization of costs				
	Preallocation FTE (a)	TA	IP	Shareholders	Excluded (b)
Dpt. Service operations					
Head of Global SO [HO001474]			100%		
Deployment & Planning [HO003110]			100%		
Health Safety & Environment [HO001454]			100%		
Global SO HR [HO001475]	100%				
Global SO Finance [HO001478]	100%				
Research & Development [HO001479]			100%		
Global Food Platform [HO001480]			100%		
Pan Europe SO [HO001472]	100%				

Facts about the audit :

2) Calculation of split factors.

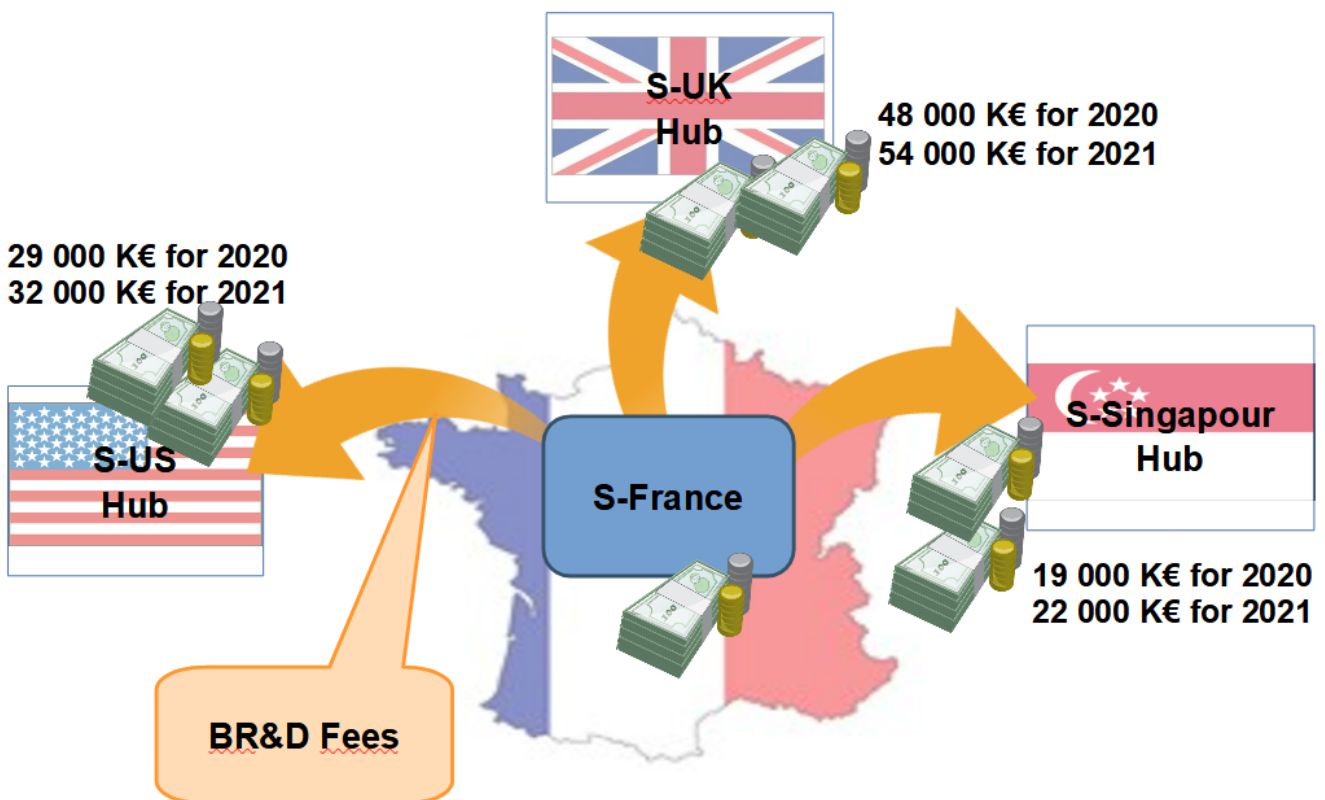
Each Hub applies these percentages to its operational expenses for its departments over the past 3 years. For each Hub, the sum of these amounts represents the expenses related to "IP".

Next, a percentage is determined for each Hub based on the proportion of its spending related to the total spending of all Hubs.

Following these steps, the group determined the following percentages as split factors:

	S-France	S-US	S-UK	S-Singapour	Total
Company's IP costs	150	50	30	20	300
Company's IP Cost / Total IP Cost	150/300	40/300	80/300	30/300	300/300
Split factors	50 %	13 %	27 %	10 %	100 %

Conclusion : Without any change in the group's activity or organization, 50% of S-France's revenue was transferred to foreign subsidiaries.



Questions (relating to the case)

- 1) Regarding this case and taking into account your legislation, how would you challenge the group?
- 2) Do you agree with the method used by the company to determine residual profit?
- 3) When determining « Entrepreneurial Capital »: Do you agree with the use of the RACI method based on employee interviews? If not, how can we challenge it?
- 4) For determining split factors: Do you agree with using operating expenses over 3 years?
- 5) What would be your approach in terms of transfer pricing, and can you explain your main lines of reasoning?
- 6) How do you calculate the amount of the transfer pricing?

Proposed solution

Problematic :

The implementation of BR&D agreements leads to a significant transfer of profit unrelated to any change in the nature of the services provided.

However, the Hubs do have activity and substance, and no anti-abuse rule applies in this particular case. The only way we found was to challenge the transfer pricing method. However, there were significant difficulties regarding for instance, the nature of the services provided by the Hubs and the interviews.

The Service's approach was to:

1. Challenge the Profit Split method used by the company;
2. Implement an alternative method.

1) Challenge the Profit Split method used by the company :

- The residual profit was not correctly *calculated* .

The profit split method is wrongly applied by the group, because it did not determine a standard remuneration for S-France. As a consequence, the shared residual profit is greater than the actual residual profit.

- *The Hubs do not perform DEMPE functions.*

The hubs provide services that are not linked to or identifiable with DEMPE functions (e.g. HR services, recruitment guidance)

- *The cost-based allocation formula does not take into account all the functions of the DEMPE.*

This method is based on total costs. It does not take into account the protection and marketing functions for instance, which are handled exclusively by S-France.

- *The method does not remunerate IP that are unique and profit-generating.*

There is no link between the functions of the Hubs and unique, value-creating IP. Based on costs over the last 3 years, S-France's historical IP (the brand), is not taken into account in the remuneration method.

Conclusion: The profit-split method is not suitable for this particular case.

Analysis of DEMPE functions

According to these new principles, only unique and profit-generating intangible assets should be subject to remuneration. The BEPS Equity Report 8-10, p. 72, states :

« *In a transfer pricing analysis of a matter involving intangibles, it is important to **identify the relevant intangibles with specificity**. The functional analysis should identify the relevant intangibles at issue, the manner in which they contribute to the **creation of value** in the transactions under review, the important functions performed and specific risks assumed in connection with the development, enhancement, maintenance, protection and exploitation of the intangibles and the manner in which they interact with other intangibles, with tangible assets and with business operations to create value.* »

The OECD's work makes it very clear that the revenues from the exploitation of **intangible** assets must be allocated to companies based on **their contribution to value creation**. The BEPS Actions 8-10 report, p. 86, states :

*« The functional analysis should identify all **factors that contribute to value creation**, which may include risks borne, specific market characteristics, location, business strategies, and MNE group synergies among others. The transfer pricing method selected, and any adjustments incorporated in that method based on the comparability analysis, should take into account all of the relevant factors materially contributing to the creation of value, not only intangibles and routine functions».*

2) Implement an alternative method :

In order to implement a new transfer pricing method, the relationships between the Hubs and S-France have been defined in accordance with the terms of the « BR&D Agreement ». According to the contract:

- S-France is the legal owner of the intellectual property and the results of the works provided by the "Hub", which is remunerated accordingly.
- The « Hub » undertakes to comply with all rules, regulations and policies imposed by S-France ;
- The « Hub » acknowledges that S-France is the « data controller » and the « Hub » is the « subcontractor ».

Therefore, according to the « BR&D Agreement » S-France is the Principal who supervises the Hubs in the performance of their services.

Furthermore, given the group's organisational structure, S-France :

- **Finances the Hubs' operations** ; and

Manages the risks associated with those activities.

2) Implement an alternative method :

In view of the functions performed, the risks assumed and the assets used, S-France must be regarded as the Principal and the foreign hubs as Service Providers.

=> S-France is regarded as performing DEMPE functions.

=> The Hubs do not perform DEMPE functions, but provide services for the benefit of S-France.

=> The remuneration of the Hubs cannot be calculated on the basis of the revenue generated by the IP.

=> In accordance with the Group's internal policy and the OECD's recommendations, the hub's remuneration is determined using the TNMM method and the Net Cost Plus as Profit Level Indicator.

Conclusion of the case :

- Application of OECD Guidelines : Action 8-10 : the **profit must be aligned on the contribution value chain**.
- S-France is the legal owner and has the **economic ownership** of the IP and should receive the income deriving from these IPs.
- The Hubs are service providers. The French tax authorities recalculated the Hubs' « BR&D Fees » using the TNMM method with a net profit margin of 7%.

The excess amount of « BR&D Fees » collected by the Hubs was treated as a transfer of profits from S-France to the Hubs.

- Application of Article 57 of the French General Tax Code regarding **Transfer Pricing to increase S-France's taxable profit by the amount of profits previously transferred to the hubs.**
- The company did not agree with the FTA's position, but we reached a final agreement.

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Budapest, Hungary

CASE STUDY 9 – Georgia

Case Submitter:

First name: Ilia Baghaturi

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Background - Description of the Case:

1. Background of the Case

Company X is a Georgian resident company, incorporated in 1998 and fully owned by a foreign parent company (Company Y, Country Y). It operates as a general agent of an international shipping line in Georgia.

Company Y benefits from a preferential tax regime (tonnage tax), creating incentives for profit allocation within the group.

2. Controlled Transactions

- Agency and logistics services provided to Company Y
- Revenue collection and local service provision
- Cross-border related-party transactions

3. Taxpayer's Position

The taxpayer applied a Cost Plus method using MOTC and Berry Ratio, concluding that its results are at arm's length.

4. Financial Overview

2021 Revenue: 1,795,284 GEL | Operating Profit: 77,880 GEL
2022 Revenue: 2,048,292 GEL | Operating Profit: 73,335 GEL

5. Tax Authority's Position

The tax authority rejected the analysis due to:

- Non-comparable companies
- Lack of cost structure clarity
- No real transaction evidence

6. Functional Analysis

Independent companies performing similar shipping agency roles were identified and analyzed, including real contracts.

7. Pricing Model Findings

Independent agents are compensated based on:

- Container volumes (TEU)
- Revenue collection
- Local services

8. Method Selection

Method: TNMM

Indicator: Operating Profit / TEU

9. Benchmarking

Company X shows significantly lower profitability compared to comparable companies.

10. Adjustment

Adjusted profit: 11,348,489 GEL

Additional tax: 2,002,674 GEL

Questions (relating to the case)

- 1) Was Cost Plus appropriate?
- 2) Is TNMM with OP/TEU justified?
- 3) How should comparability be assessed?
- 4) What is the impact of preferential tax regimes?
- 5) Is OP/TEU a reliable indicator?
- 6) Is median-based adjustment appropriate?

Proposed solution

Based on the facts, the tax audit concluded that the Transactional Net Margin Method (TNMM) is the most appropriate method for evaluating the transactions, and the selected profit level indicator is operating profit per total cargo volume (Operating profit/TEU), as market analysis and the examination of agreements between independent parties (the info is mostly private) showed that this most objectively reflects the allocation of revenue and operating profit between independent parties.

Company X's financial indicator, operating profit per total cargo volume (Operating profit/TEU), is significantly lower than the comparable companies' operating profit per total cargo volume and does not fall within the arm's length range.

As a result, the company's taxable profit was calculated as follows:

The median operating profit per total cargo volume (Operating profit/TEU) of comparable companies multiplied by Company X's total cargo volume.

Under this approach, the calculated operating profit for the period (01.11.2021–01.01.2023) amounted to a total of 11,348,489 GEL, and the corresponding corporate income tax calculated under this method amounted to 2,002,674 GEL.

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CASE STUDY 10 – Germany

Case Submitter:

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Background - Description of the Case:

Background of the Case "Parallel imports"

A German corporation (GDC) distributes prescription, patent-protected medicines in Germany on behalf of its foreign parent company. It obtains these from a foreign affiliate. GDC performs several functions in Germany like Regulatory and Licensing (after Europe-wide authorization), Marketing and Promotion, Purchasing and Inventory Control, Warehousing and Logistics and After Sales Services.

The purchase of goods from the foreign affiliated company and the subsequent domestic distribution constitutes the pharmaceutical group's own and first domestic distribution channel. In addition, there is a second domestic distribution channel known as parallel imports. Third-party wholesalers buy medicines abroad from affiliated companies of GDC and place them on the domestic market.

The economic background is that the selling prices of the medicines abroad are in some cases considerably

lower than the domestic selling prices, so that parallel importers are able to offer the medicines at lower prices than GDC.

The decision as to whether a parallel import or a medicinal product distributed by GDC is to be supplied to the patient is made solely by the pharmacist. Under the import promotion clause pursuant to Section 129 I No. 2 of the SGB V, pharmacies are obliged to supply low-priced imported medicinal products to a certain extent when supplying prescribed medicinal products to insured persons in accordance with a framework contract.

In the pharmaceutical industry there are two main value drivers. On the one hand, R&D and on the other, marketing. Everything else, such as production, is of secondary importance in the audit period.

Marketing for the medicines is carried out primarily through the company's own sales force, but also partly through third-party companies acting on behalf of GDC.

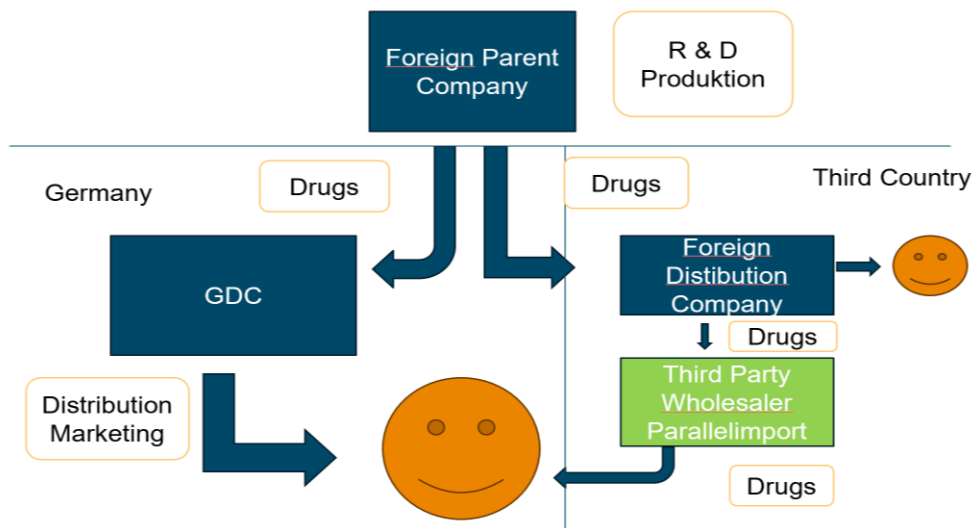
Remuneration for the company's own pharmaceutical representatives and the 'marketing companies' is based on turnover, whereby turnover from parallel imports is also included in the basis of assessment.

Under the Group's transfer pricing system, GDC receives a turnover-related remuneration (control on an operating margin based on its own turnover). For parallel imports, the domestic distribution company does not receive a separate remuneration.

Consequence of parallel imports:

As a result of the second distribution channel opened up by the parallel imports, GDC suffers a reduction in turnover and thus in profits compared with the sale of all medicinal products sold domestically through its own distribution channel.

The Group itself continues to sell the same amount of drugs, but it achieves a lower overall profit because some of the drugs are sold in Germany at 'foreign prices.' The Group's foreign distributors achieve higher sales and thus higher profits



Position of the taxpayer

- Parallel imports cannot constitute hidden profit distributions because:
 - The corporate group has no influence on parallel imports
 - Parallel imports are not in the interest of the corporate group, as they reduce overall profits of the corporate group,
 - Parallel imports have only a very minor impact on GDC's profit margin,
 - Parallel imports are already co-remunerated via the agreed profit margin.

Questions (relating to the case)

Legal questions:

- 1) Does the absence of remuneration for the sales of parallel imports constitute a hidden profit distribution in favor of the foreign parent company?
- 2) If it is a hidden profit distribution, how should it be remunerated?
- 3) What is the arm's length remuneration of the "parallel imports"?

Proposed Solution

Position of the German tax administration

- Parallel imports lead to an incorrect distribution of profits within the Group.
 - The profit of GDC is reduced due to the lower turnover.
 - The profit of a foreign affiliated distributor is increased due to the higher turnover, although the marketing service leading to the higher turnover was provided by GDC.

Therefore, GDC should have received a compensation. The non-payment of compensations constitutes a hidden profit distribution.

Audit result

The hidden profit distribution was calculated at 3% of the estimated sales of the foreign affiliated distributor.

This calculation was based on the assumption that GDC generally receives a total fee for its activities as a wholesaler and for providing marketing services. In this case, the wholesaler fee is due to the foreign distributor, so GDC only has to receive a reduced fee for its marketing services.

Lawsuit before the tax courts

- The taxpayer has filed a lawsuit against this finding of the tax audit before the tax court.
- The Tax Court ruled in favour of the taxpayer.
- The tax office appealed to the Federal Finance Court (Bundesfinanzhof; BFH)
- BFH ruled that the decision of the Financial Court was not sufficiently reasoned.
 - The tax court has to decide on the case again and check whether third parties would have paid a compensation in this case.
 - BFH considers that the minimum amount for the compensation is the expenses of the sales force attributable to the parallel imports plus an appropriate profit mark-up

Other procedures:

This topic is currently being discussed in a MPA and an APA with the financial administration of the parent company.

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Budapest, Hungary

CASE STUDY 11 – Hungary

Case Submitter:

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Background - Description of the Case:

The Hungarian resident company ("A") was part of a multinational group and acted as the legal owner of certain trademarks and brand names. Related manufacturing entities paid royalties to "A" amounting to 2% of their net sales for the use of these trademarks. The royalty rate was supported in the original transfer pricing documentation by applying the Comparable Uncontrolled Price (CUP) method, and no transfer pricing adjustment was made in the original corporate income tax returns.

Following a change in group structure and an internal tax review, the group performed a DEMPE analysis (Development, Enhancement, Maintenance, Protection and Exploitation of intangibles). According to this analysis, the Hungarian entity's role was limited to legal ownership and routine protection of the trademarks, while the economically significant DEMPE functions were performed by a Spanish group company ("C").

Based on this, the taxpayer submitted self-revisions for the years 2019-2022. In these, the applied royalty rate was reduced from 2% to 0%, and a full downward transfer pricing adjustment was made, resulting in a total tax base decrease of HUF 13.4 billion. Consequently, the corporate income tax liability was reduced by approximately HUF 1 billion. To support the adjustment, the taxpayer provided a statement issued by the Spanish company "C", confirming that it had taken (or would take) the corresponding amount into account in its own tax base. However, no such documentation was obtained from the actual contractual counterparties, i.e. the manufacturing entities paying the royalties. The taxpayer also relied on a prior ruling request submitted to the tax authority. The ruling confirmed, at a general level, the relevance of the OECD Transfer Pricing Guidelines and the DEMPE framework in determining entitlement to income from intangibles. However, it did not address the full group-wide income allocation nor the specific domestic legal requirements for downward adjustments.

A compliance audit was initiated to assess the legality of the self-revisions.

Questions (relating to the case)

1. Can the statutory requirement for documentation and statements supporting a downward transfer pricing adjustment be satisfied by a related party other than the actual contractual counterparty to the controlled transaction?
2. Is it acceptable, from a transfer pricing perspective, to allocate the entire royalty income to a group entity that was not a party to the original licensing transactions?
3. Is the purpose of the DEMPE analysis to identify a single "economic owner" of an intangible, or rather to support the allocation of income among all contributing entities?
4. Can the arm's length remuneration of a legal owner be reduced to (near) zero solely based on the absence of significant costs, even if it performs ongoing protection and administrative functions?
5. If the total royalty amount remains arm's length at the level of the manufacturing entities, should the DEMPE analysis lead

- to a full reallocation of income or rather to a reallocation of that income among relevant parties?
6. Is it acceptable that the same functions are remunerated both through service fees and through entitlement to royalty income?
7. If the taxpayer had fulfilled the formal legal requirements (i.e. obtained statements from the actual counterparties), to what extent could the tax authority still challenge the adjustment on substantive transfer pricing grounds?

Proposed Solution

The tax authority rejected the self-revisions on two independent grounds. First, the formal and substantive conditions for applying a downward adjustment under the Hungarian Corporate Income Tax Act were not met. Under the law, such adjustment requires documentation and a statement from the related party with which the taxpayer has concluded the controlled transaction. In this case, the contractual counterparties were the manufacturing entities, not the Spanish company "C". Therefore, the statement provided by "C" was not sufficient to meet the statutory requirements. The tax authority also rejected the taxpayer's argument that OECD principles or the substance-over-form approach could override explicit domestic legal conditions.

Second, the tax authority did not accept the conclusion drawn from the DEMPE analysis that the entire royalty income should be allocated to a single entity ("C") as the "economic owner" of the intangibles. According to the tax authority, the purpose of the DEMPE analysis is not to identify a single owner of the income, but to ensure that profits are allocated among all entities that perform relevant functions, use assets, and assume risks.

Based on the facts, not only the Spanish company "C", but also the Hungarian entity and the manufacturing entities performed relevant functions and assumed risks. The Hungarian company carried out legal protection and administration of the trademarks. The manufacturing entities were responsible for local marketing and sales activities and bore significant business risks. At the same time, the costs of central marketing and brand management functions performed by "C" were already charged to the manufacturing entities through intra-group service fees. The tax authority therefore concluded that it was not justified for "C" to receive both service fees and the full royalty income for the same underlying functions. Consequently, the royalty income should have been allocated among the involved entities in line with their actual contributions, rather than fully reallocated to one entity.

The case also highlighted the importance of formal requirements under domestic law. Since the taxpayer did not obtain the required documentation from the actual contractual counterparties, the downward adjustment was not acceptable on this basis alone. This also indicates that if the taxpayer had fulfilled these formal requirements, the tax authority would have had to challenge the adjustment primarily on substantive transfer pricing grounds, involving a significantly more complex analysis.

Following the audit findings, the taxpayer submitted revised self-revisions and reversed the previously claimed tax benefit in full.

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Budapest, Hungary

CASE STUDY 12 – Italy

Case Submitter:

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Background - Description of the Case:

The case concerns an intra group arrangement involving a company performing limited risk sales support activities on behalf of a related foreign principal. The taxpayer operates without owning intangibles, without assuming significant commercial or financial risks, and by following centrally defined commercial policies. The controlled transaction under review relates to the provision of routine services connected to the promotion and support of the sales of principal's products in the local market.

During the analysis, several issues emerged, particularly regarding the correct delineation of the controlled transaction, the identification of the functions performed, and the classification of operating expenses. A key challenge was determining whether the value created by the taxpayer was effectively linked to its operating costs, and whether the functional profile was consistent with that of a low-risk service provider. Additional complexities arose in assessing comparability with independent entities and in evaluating whether the taxpayer's activities could influence or contribute to the development or exploitation of group intangibles.

The case provides the necessary background for examining the appropriateness of applying the Transactional Net Margin Method (TNMM) with the Berry Ratio as the profit level indicator, in line with the OECD Transfer Pricing Guidelines. The information provided allows participants to understand the economic context, the roles of the parties involved, and the issues that must be addressed in order to reach a consistent transfer pricing conclusion.

Questions (relating to the case)

1. Do you consider Alfa as a low risk service provider according to the functional and risk profile?
2. What challenges do you see in the use of the Berry Ratio in complex multinational groups?
3. How important is the correct classification of costs in this analysis?
4. In your opinion, is the Berry Ratio applicable to the case?

Proposed Solution

The tax administration approached the case by first conducting a detailed delineation of the controlled transaction, focusing on the economically relevant characteristics of the relationship between Alfa and its foreign principal. The analysis confirmed that Alfa performs routine sales support and marketing activities, implements centrally defined commercial strategies, and does not control key value drivers such as pricing, commercial policies, or contractual terms. Alfa does not own or develop intangibles and does not assume significant commercial or financial risks. These elements supported its characterization as a low-risk service provider.

During the review, several challenges emerged. The first related to the use of the Berry Ratio as a profit level indicator. Although the OECD Transfer Pricing Guidelines (paragraph 2.106) recognize the Berry Ratio as suitable for low-risk intermediaries, its application in complex multinational groups may be problematic. Differences in cost allocation, centralized group policies, and the potential presence of intangibles can distort

the relationship between operating expenses and gross profit. In addition, the indicator is sensitive to external factors (e.g., commodity driven revenues), which may weaken the link between costs and value creation.

A second challenge concerned the correct classification of costs. Since the Berry Ratio is defined as Gross Profit / Operating Expenses, any misclassification—such as treating capital expenditures as operating costs or inconsistently allocating intercompany charges—can artificially inflate or deflate the indicator. Furthermore, differences in accounting policies across group entities may compromise comparability with independent benchmarks.

To address these issues, the tax administration adopted a structured methodology. The analysis focused on:

- verifying the consistency of Alfa’s functional profile with that of a low-risk service provider;
- reviewing nature and allocation of operating expenses to ensure they reflected only routine support functions assessing the comparability of external benchmarks, taking into account differences in cost structures.
- evaluating whether Alfa contributed to or exploited group intangibles.
- considering alternative indicators where appropriate.

The outcome of the case confirmed that Alfa’s remuneration should reflect its limited risk profile. However, the analysis also highlighted that the Berry Ratio, while theoretically applicable, may not fully capture the value drivers of Alfa’s activities, which are linked more to the volume of intermediary goods and the remuneration per ton than to operating expenses. For this reason, the administration complemented the analysis with additional indicators, including a risk free return adjustment and a ROS based assessment, to ensure a more robust evaluation.

The adopted position did not lead to legislative amendments, but it contributed to internal reflections on the appropriate use of the Berry Ratio in cases involving mixed functions or potential exposure to group intangibles. The case also reinforced the importance of consistent cost classification and careful comparability assessment when applying profit indicators in complex multinational environments.

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Budapest, Hungary

CASE STUDY 13 – Montenegro

Case Submitter:

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Background - Description of the Case:

Key Risks

In companies with significant international transactions: Companies that regularly engage in transactions with related parties in other countries may face higher risk due to differing tax rates and rules across jurisdictions.

In companies with low profitability: If a company consistently reports low or no profit while related companies in other countries report high profitability, this may indicate potential transfer pricing irregularities.

In companies trading Intellectual Property: Transactions involving licenses, patents, and other intellectual property are often complex, and determining an arm's-length price can be difficult, increasing the risk of irregularities.

In newly established companies: Newly established companies that immediately engage in significant transactions with related parties abroad may face increased scrutiny.
In companies with high levels of debt to related parties: If a company has a high level of debt to related companies, this may indicate potential manipulation of interest rates or other terms to shift income.

In companies operating in tax havens: If a company conducts substantial transactions with related parties in low-tax jurisdictions, this may signal potential risk.

Case Description

Company A from Montenegro manufactures electronic components.
Company B from Germany is a related entity that distributes the products in the EU market.
Company A sells a component to Company B at a price of €50 per unit.

Questions (relating to the case)

- 1) The transfer price between Company A and Company B is 50 €.
- 2) The price is not in line with the arm's-length principle.
- 3) Corporate Income Tax Adjustment

Proposed Solution

Transfer Pricing Issue

Since the companies are related parties, the price between them must be determined according to the arm's-length principle'.

This means the price should correspond to the price that would be applied between independent companies.

Applied Method: Comparable Uncontrolled Price (CUP)

Analysis of Market Transactions Shows:

- Market price range between unrelated companies: €65 – €75€

Transfer pricing analysis

Internal Transfer Price: 50 €

Conclusion: The price is significantly below the market range.

The transfer price between Company A and Company B is 50 €.

The price is not in line with the arm's-length principle.

Corporate Income Tax Adjustment

Conclusion

The transfer price between Company A and Company B is 50 €.
The price is not in line with the arm's-length principle.
Corporate Income Tax Adjustment

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CASE STUDY 14 – Poland

Case Submitter:

First name: Paweł Janiszewski

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Background - Description of the Case:

I. Description of the case

The Ministry of Finance has provided a list of entities in the area of transfer pricing for the purpose of conducting detailed analyses and considering the initiation of tax audits.

An analysis of Company PL was conducted based on data held by the tax authority, financial reports, and publicly available online sources.

The challenge was to find arguments for initiating a transfer pricing tax audit based solely on the available information.

Company PL has been operating in Poland for over 10 years and manages a shopping mall.

Company PL reported a gross loss of approximately PLN 27 million and turnover of approximately PLN 266 million between 2019 and 2024.

In its financial statements, Company PL stated that it operates as a **special purpose vehicle** (SPV) in the real estate industry and in a given year it may not realize revenues and/or profits until the investment is completed/commercialized, and one-year profitability ratios may be negative.

Company PL borrowed PLN 444 million from an indirect shareholder (Company FR), probably to purchase a shopping mall.

The CIT tax audit began in March 2026 for 2023.

I. A short presentation of the case

Ownership structure



Balance Sheet						
Accounting year	2019	2020	2021	2022	2023	2024
Statement on	31-12-2019	31-12-2020	31-12-2021	31-12-2022	31-12-2023	31-12-2024
Accounting period [months]	12	12	12	12	12	12
Unit	ths PLN	ths PLN	ths PLN	ths PLN	ths PLN	ths PLN
ASSETS (Aktywa)						
A. FIXED ASSETS	376 276	369 603	354 461	349 132	298 824	308 967
IV. Long-term investments	373 009	366 961	351 492	345 380	296 572	306 944
1. Real property	373 009	366 961	351 492	345 380	296 572	306 944
LIABILITIES						
A. EQUITY	-37 330	-71 050	-72 763	-70 394	154 203	183 292
I. Share capital	5	5	5	5	123 235	123 235
IV. Supplementary capita ⁷					123 230 ¹	30 968
VII. Previous years profit	-36 382	-37 334	-71 055	-72 768	-70 399	
VIII. Net profit (loss)	-953	-33 721	-1 713	2 369	-21 863	29 089
B. LIABILITIES AND PROVISIONS FOR LIABILITIES	430 292	473 120	469 978	455 103	155 472	152 183
II. Long-term liabilities	426 231	461 843	460 341	418 134	146 221	143 910
1. To related parties	424 331	459 834	458 300	415 728	143 484	141 009
Profit & Loss Account (comparative variant)						
A. Net revenues from sales and equivalent, including revenues:	43 668	34 798	40 417	45 632	49 942	51 774
- from related parties	1 764	1 764	1 764	1 764	1 764	1 764
B. Operating expenses	34 292	30 322	32 877	38 958	41 366	37 010
I. Amortisation and depreciation (amortyzacja)	15 744	15 718	15 708	15 743	15 791	11 400
C. Profit (loss) on sales (A-B)	9 376	4 476	7 540	6 674	8 576	14 764
D. Other operating revenues	159	8 764	1 121	12 317	571	20 949 ²
III. Other operating revenues	36	51	122	184	10	26
E. Other operating expenses	2 486	2 608	4 244	21	39 784 ³	101
II. Revaluation of non-financial assets	2 415	2 267	4 334		39 397	82
F. Profit (loss) on operating activities (C+D-E)	7 049	10 632	4 417	18 970	-30 637	35 612
G. Financial revenues	4 165	73	1 611	328	24 298	2 938
II. Interest, including:	156	73	68	328	455	571
- from related parties	110	73	40	255	435	560
V. Other⁵ (inne)	4 009		1 543		23 843	2 367
H. Financial expenses	11 418	44 186	7 814	16 168	15 189	7 990
I. Interest, including:	11 418	9 918	7 814	7 837	15 189	7 990
						51 406
						1 473⁴
						31 762

¹ Agio. On August 4, 2023, the Company's shareholder increased the company's capital to PLN 123,234,750.

² Other operating income - write-down of fixed assets

³ Other operating costs - property impairment write-off

⁴ income related to "other interest" from related entities

⁵ realized and unrealized exchange rate differences

- for related parties	11 418	9 918	7 814	7 837	15 187	7 990	60 164 ⁶
IV. Other ⁷ (inne)		34 268		8 331			42 599
K. Gross profit (loss) (I±J)	-204	-33 481	-1 786	3 130	-21 528	30 560	-23 309
L. Income tax	749	240	-73	761	335	1 471	3 483
N. Net profit (loss) (K-L-M)	-953	-33 721	-1 713	2 369	-21 863	29 089	-26 792

The controlled transaction(s) at stake: loan from the FR Company, i.e. from a related entity

The chosen or proposed approach/ method: loan may be treated as a subscription of capital

The reasons why it was selected for the purpose of the particular case or problem under discussion.

Company PL as SPV received a large loan from a related entity without having creditworthiness. The interest on the loan burdened the SPV's financial results, causing losses on its business operations.

Questions (relating to the case)

- 1) What about the chosen or proposed approach? Is it correct? Maybe there are other approaches.
- 2) Issue/question: On August 4, 2023, the Company's shareholder increased the company's capital to PLN 123,234,750. Why didn't the company do this earlier?
- 3) What is the role of the Company NL?
- 4) Why didn't the Company FR buy the shopping mall itself?
- 5) Does Company PL have the right to make losses?

Proposed Solution

The chosen or proposed approach/ method: loan may be treated as a subscription of capital. Articles 1.65 and 1.66 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010) may be used to provide loans to subsidiaries:

1.65 However, there are two particular circumstances in which it may, exceptionally, be both appropriate and legitimate for a tax administration to consider disregarding the structure adopted by a taxpayer in entering into a controlled transaction. The first circumstance arises where the economic substance of a transaction differs from its form. In such a case the tax administration may disregard the parties' characterisation of the transaction and re-characterise it in accordance with its substance. An example of this circumstance would be an investment in an associated enterprise in the form of interest-bearing debt when, at arm's length, having regard to the economic circumstances of the borrowing company, the investment would not be expected to be structured in this way. In this case it might be appropriate for a tax administration to characterise the investment in accordance with its economic substance with the result that the loan may be treated as a subscription of capital. The second circumstance arises where, while the form and substance of the transaction are the same, the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price. An example of this circumstance would be a sale under a long-term contract, for a lump sum payment, of unlimited entitlement to the intellectual property rights arising as a result of future research for the term of

⁶ According to the additional information to the financial statement, the amount concerns interest costs on interest received by the Company on loans from related entities.

⁷ According to the additional information to the financial statements, these are realized and unrealized exchange rate differences.

the contract (as indicated in paragraph 1.11). While in this case it may be proper to respect the transaction as a transfer of commercial property, it would nevertheless be appropriate for a tax administration to conform the terms of that transfer in their entirety (and not simply by reference to pricing) to those that might reasonably have been expected had the transfer of property been the subject of a transaction involving independent enterprises. Thus, in the case described above it might be appropriate for the tax administration, for example, to adjust the conditions of the agreement in a commercially rational manner as a continuing research agreement.

1.66 In both sets of circumstances described above, the character of the transaction may derive from the relationship between the parties rather than be determined by normal commercial conditions and may have been structured by the taxpayer to avoid or minimise tax. In such cases, the totality of its terms would be the result of a condition that would not have been made if the parties had been engaged in arm's length transactions. Article 9 would thus allow an adjustment of conditions to reflect those which the parties would have attained had the transaction been structured in accordance with the economic and commercial reality of parties transacting at arm's length.

Adopting this approach requires addressing the issue of how much of a loan should be converted into equity in accordance with the arm's length principle. An independent entity has the right to take out a loan.

A proposal is to examine the market debt-to-equity ratio of loans. Such a solution was already successfully implemented during the other tax audit 10 years ago.

IOTA Case Study Workshop “Advanced Transfer Pricing Issues”

29 - 30 April 2026
Budapest, Hungary

CASE STUDY 15 – Portugal

Case Submitter:

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Background - Description of the Case:

1. ENTITIES INVOLVED

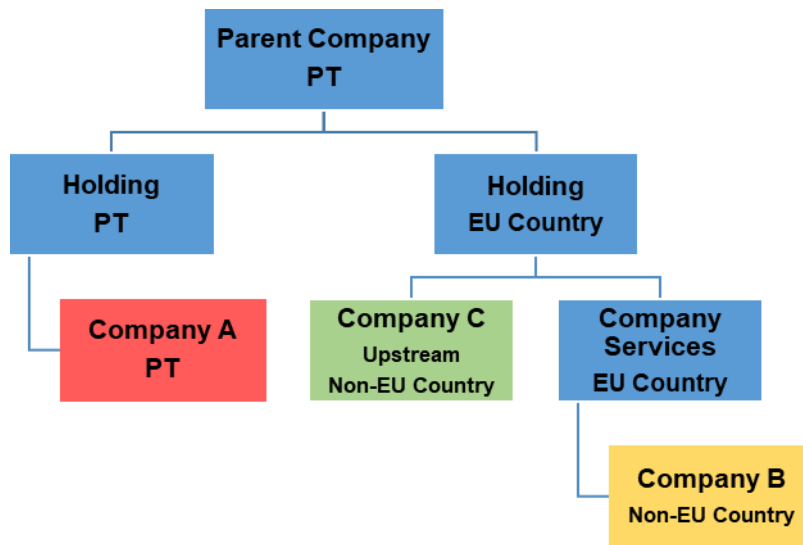
Company A (PT – our taxpayer)

Company B (related company based in a Non-EU country)

Relationship between the parties:

Both Company A and Company B are owned by the same multinational Group (from now on "Group").

Figure 1 - Group organization chart



2. IDENTIFYING THE TRANSACTION: FUNCTIONS, ASSETS AND RISKS

Company A operates in the refining, selling, transportation and distribution of petroleum products - selling its products mainly to the local market (70%) and also to other countries. It is the only company of the Group operating in the oil refining sector, controlling most of the distribution of refined products through its own brand. In order to carry out its processing and production activities, Company A needs to purchase raw materials, such as crude oil, which it does through Company B.

Company B's main activity is trading oil products and it manages the acquisition of crude oil and other raw materials with a view to maximizing the refining margin of Company A, taking into account the supply diversification strategy and the specific characteristics and needs of Company A's refining system. So, Company B purchases crude oil (and other oil products) from independent suppliers and then resells it to Company A.

The physical circuit of the products does not pass through Company B's country, but goes directly from the supplier's origin to Company A's refinery outside Company B's Country. The transport, freight and insurance costs, taxes and import duties are borne in accordance with the Incoterm1 agreed between the parties in the contract.

Company A and Company B set up a "Product Sales Agreement" concerning the purchase of these products by Company A which provides the following pricing methodology:

- crude oil purchases: the price shall be the same as agreed between Company B and his supplier plus a premium of 0,15USD/BBL.;
- other oil product purchases: the price is calculated using the market price plus a marketing fee of 2% (the market price is the price at which Entity B purchases from its supplier).

The purchase of crude oil and other oil products by Company A from Company B represents approximately 35% of its operating expenses. Company A purchases almost 70% of all crude oil and other oil products from Company B (about 10.000 million \$), and 30% directly from independent third parties (about 4.000 million \$). So, the high reporting of costs in Company A represents a high retained margin in Company B. For this reason, questions have been raised in the Portuguese Tax Authorities (PTA) about what kind of functions Company B

really performs and what risks it assumes to warrant such an apparently excessive remuneration.

1 Incoterms (International Commercial Terms) are 11 standardised rules established by the International Chamber of Commerce (ICC) that define the responsibilities of buyers and sellers in international trade. They establish who pays for transport, insurance and customs expenses, as well as determining the exact point of transfer of risk (loss or damage).

Otherwise, there is also another related company in the group, Company C, which operates in the crude oil exploration and production segment (Upstream company). And it appears from some of the information provided that one of Company B's suppliers is the related company itself.

In summary, Company B acts as an intermediary for Company A in crude oil purchases from independent suppliers and also from Company C (oil supplier/producer within the group). Based on the information gathered to date, the PTA considers that Company B's remuneration, for oil purchases made by Company A, is the same regardless of whether Company B's suppliers are independent producers or the producer related entity C.

2.1. Tax Administration's approach to the case

As part of the inspection procedure (still ongoing), the Portuguese Tax Authority requested the taxpayer (Company A) to provide some clarifications on the transaction itself, in order to try to understand what functions were performed in Portugal and in the third country and what risks were assumed respectively, that justify that the margin retained in the country B is in accordance with the arm's length principle.

The aim is to understand, first of all, whether the pricing methodology used is appropriate to the functions performed and risks assumed by Company B, and whether it would make sense for it to be remunerated using the cost-plus method as a risk-free service provider.

Also, is not excluded the possibility to ascertain the economic substance of Company B, since, from the investigations carried out and the results of previous inspection procedures, it can be inferred that the functions that they claim to perform at Company B, in the third country, are in fact performed by Portuguese employees who are seconded for periods of time to the third country to, apparently, give economic substance to the company.

The PTA has already requested a set of elements from the taxpayer to support the analysis, namely:

- a detailed description of the exact role played by Company B in Company A's transactions in which it participates as an intermediary, by identifying the functions directly and indirectly performed by the former in the process, the assets it employs in them and the risks it incurs, for the purpose of demonstrating that the remuneration assigned to it by Company A in this context is in line with the functions it actually performs;
- data on Company B employees, including details of their roles and respective professional categories, for the purpose of demonstrating that the entity has the effective capacity to perform the functions described;
- Company B's financial data (namely its annual accounts, including the balance sheet and income statement), for the purpose of demonstrating that it has a financial structure that gives it the capacity to perform the functions described and assume the risks associated with them.

As far as PTA knows:

- Company B has low equity, assets and operating costs, so no structure to assume such risks;
- The trading activities and the acquisition and sale of crude oil are carried out by three employees at Company B who, as already mentioned, are Portuguese employees seconded to country B for periods

of time. We have information that one of these employees has a high level of know-how and experience in trading, and the other two were previously performing support functions in trading for Company A. However, all management decisions seem to be made in Portugal, under the Trading & Supply department of Company A;

- Two of the directors of Company B are also employed by Company A;
- The remuneration retained by Company B on the acquisition of other oil products is much higher and depends not only on the volumes traded but also on the market prices used as a reference for the purchases to third parties. No different functions were identified concerning the different oil product acquisitions;
- Company A couldn't explain the reason for using an intermediary in the acquisition of raw materials. Company B's acquisitions from independent third parties are based on market prices, so can be assumed as arm's length. Some suppliers sold products to both companies and some of the products were originally sold to Company B by Company C (related party). No foreseeable economic advantage on the intermediation of Company B;
- Only 80% of Company B's sales are traded with Company A. It was not possible to identify the kind of products, its origins and costumers of 20% of Company B's sales. PTA believes that it concerns to crude oil extracted by Company C and sold to third parties via Company B.

Questions (relating to the case)

- 1) Although we have little evidence on which to base a definitive and well-founded conclusion, we leave you with some questions for reflection:
- 2) What is the appropriate remuneration for Company B in the non-EU Country?
- 3) Are Company B's functions really relevant to the operation of Company A? Can we accept any foreseeable advantage of having an intermediary company solely for trading activities in the non-EU Country considering that those functions are performed and managed by Company A's employees, and Company A is the only identified customer of oil products sales intermediated by Company B?
- 4) Should the remuneration attributed to Company B follow the same methodology for purchases of crude oil from independent suppliers and from related entity C?
- 5) Would you apply the cost-plus method knowing that Company B also acts as an intermediary in Company C's oil sales?
- 6) In these circumstances, might it make sense to tax Company B in Portugal based on its effective direction? Or reallocate its profits to Company A, treating the group structure as artificial?

Proposed solution

As mentioned, this case is currently under inspection and, therefore, taking into account the information presented by the taxpayer at that date, we believe that the most viable solution would be to change the pricing methodology proposed by the taxpayer to a cost-plus method, considering that Company B is a simple service

provider with limited risks.

Reasons that lead Portuguese TA to follow this approach:

- the Portuguese Tax Authority considers that there is consistent evidence that Company B does indeed have economic substance, and therefore accepts this assumption;
- there are indeed employees with the appropriate know-how to carry out activities at Company B, working physically in the Company B's offices;
- the activities that Company B carries out consist of the purchase, logistical management and resale of crude oil or oil products, assuming very limited price and market risk;
- Company B only executes market orders in proportion to the orders placed and controlled by Company A;
- Company B does not decide what quantities, types of crude oil and petroleum products to order. This decision is made by Company A, and Company B only purchases according to Company A's needs;
- Company B does not assume any inventory, operational or financing risk, and sometimes does not even assume any logistical risk.

In conclusion:

For these reasons and, without excluding the fact that this inspection procedure is still ongoing, the remuneration that the Portuguese TA thinks to be the most appropriate to the functions performed and risks assumed by Company B will probably be the result of the total costs incurred by the company in its trading activities (mainly in the purchase and resale of oil or petroleum products), plus a simple margin (3%–5%) on any value-added cost identified. Company B merely acts as an intermediary between independent suppliers and Company A.

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CASE STUDY 16 – Republic of Korea

Case Submitter:

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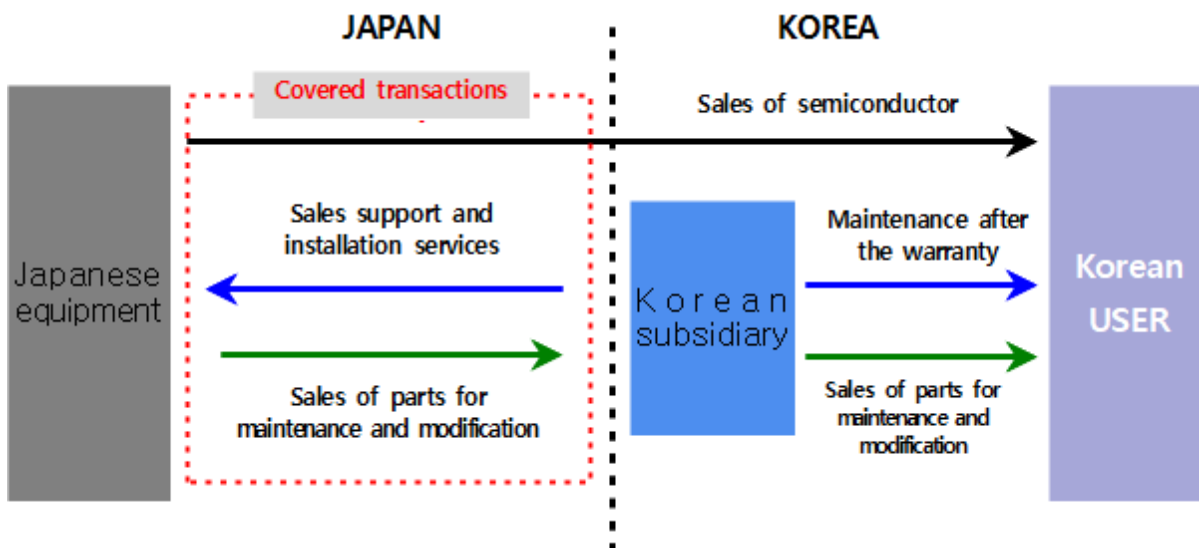
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Background - Description of the Case:

The semiconductor industry is characterized as a high-tech, high-risk, high-value-added, and cyclical business, requiring large-scale capital investment in manufacturing facilities (approximately KRW 30 trillion per fab).

- The memory semiconductor market, a core segment of Korea’s semiconductor industry, experienced rapid growth in 2020 due to increased demand for IT devices during the COVID-19 pandemic.
 - Although the market contracted in 2022–2023 due to declining demand, it is expected to grow by more than 10% in 2024.
- Continued growth is anticipated, driven by the expansion of AI and big data industries.
- (Outbound) Contract manufacturing entities in the U.S. and China, along with semiconductor sales entities located in multiple countries
- (Inbound) Sales of semiconductor manufacturing equipment and electronic materials through a Japanese subsidiary structure
- Close collaboration with the Korean subsidiary in semiconductor R&D and production processes
- Establishment of a sales support entity in Korea, with an APA filed for transactions involving sales support and installation services



Characteristics of the Semiconductor Equipment Market

- The semiconductor equipment industry has only 2–4 competitors per equipment type, with high barriers to entry
- Demand is concentrated among a limited number of large corporations (e.g., Samsung, SK hynix, LG), resulting in a buyer-driven market
- Traditional promotional activities such as marketing and advertising are not conducted; instead, direct customer engagement and long-term relationship building are essential
- Semiconductor equipment requires ongoing maintenance, repair, and modification services, making the reliability and continuity of such services a key factor in purchasing decisions
 - Prompt installation and post-installation services are critical

Proposed Solution

Functional Analysis of the Korean Subsidiary

The entity performs functions equivalent to a substantive distributor rather than a mere sales support service provider.

- Key determinants of equipment sales include:
 - Establishing trust through continuous customer relationship management
 - Collecting technological development information
 - Communicating customer specifications to technical departments
 - Providing stable installation, maintenance, and operational support
- All of these functions are performed by the Korean subsidiary
- Although the Korean subsidiary's overall functions are directly linked to sales and resemble those of a general distributor:
 - Viewing these functions in isolation and characterizing them as mere service provision distorts the entity's true nature
 - The absence of direct invoicing for equipment sales does not imply that the entity performs only support services; the substance of the transaction must be considered
- The Korean subsidiary performs most functions typically undertaken by a distributor and contributes directly to the sales of Japanese equipment manufacturers
→ Therefore, it is more appropriately characterized as a substantive distributor

Selection of PLI

- Considering the comprehensive functions performed by the Korean subsidiary, it is closer to a substantive distributor, and thus the **converted operating margin (Converted OM)** is considered an appropriate profit level indicator
- The Korean subsidiary:
 - Actively contributes to semiconductor equipment sales by collecting investment information from domestic customers (e.g., Samsung Electronics, SK hynix, LG Display) and supporting negotiations
 - Performs essential functions such as installation, warranty and non-warranty after-sales services, and import and resale of replacement parts
- Although equipment sales and costs are not recorded in its financial statements, the functions performed by the Korean subsidiary directly contribute to increasing the revenues of Japanese equipment manufacturers

Calculation Method of Converted OM

Operating Profit / Converted Revenue

- Converted revenue is calculated based on the assumption that the Korean subsidiary functions as a distributor:
 - Add:
 - Reported revenue of the Korean subsidiary
 - Sales to Korea by Japanese equipment manufacturers
 - Less:
 - Installation service fees already included in the Korean subsidiary's revenue
 - Maintenance service fees
 - Sales support service fees that would not arise under a distributor model

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CASE STUDY 17 – Romania

Case Submitter:

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Background - Description of the Case:

AUTO SRL is a Romanian company and a subsidiary of a multinational group ultimately owned by the French company AUTO PCE.

The company operates a manufacturing facility in Romania and its main activity consists of manufacturing automotive parts according to customer specifications.

Based on the tax returns submitted by the taxpayer, the following key aspects were identified:

- Approximately 90% of the finished products are invoiced directly to third-party customers.
- The company has recorded accounting losses for three consecutive years.

The tax audit period covers the years 2019–2021.

AUTO SRL performs mainly operational and production-related functions, including:

- manufacturing of automotive parts
- logistics and transportation activities

The management of the Romanian plant is carried out by individuals delegated from the French parent company, who oversee the relationship with the Romanian entity.

AUTO PCE performs strategic and entrepreneurial functions, including defining business strategy, establishing marketing policies, development of the product portfolio.

AUTO SRL sells its production as follows:

- approximately 10% of the production is invoiced to related parties
- approximately 90% is sold directly to third-party customers

According to the taxpayer’s transfer pricing documentation:

- For sales to related parties, AUTO SRL considers itself a limited-risk manufacturer.
- For sales to third parties, AUTO SRL considers itself a fully-fledged manufacturer, while the French entity is treated as a service provider for identifying customers and negotiating prices and contractual terms, negotiating raw material purchase prices, providing technical and financial consulting, providing quality control assistance.
- In its transfer pricing documentation, AUTO SRL applied the TNMM and prepared a comparability study to test the following transactions:
 - sales of finished goods to related parties.
 - intra-group services provided by the French affiliate.

The taxpayer argues that:

- the losses incurred by AUTO SRL are generated by the production sold to third parties
- the sales to related parties generate profitability above market level
- the services provided by the French entity are priced at arm's length

Questions (relating to the case)

1. What do you consider to be the primary issue in this case and how would you approach it?
2. Do you believe that the functional profile presented by the taxpayer reflects the economic reality?
3. What additional questions or information requests would you address to the Romanian entity in order to obtain a complete understanding of the business model?
4. What would be the appropriate approach for determining the arm's length remuneration, and why?
5. How would you calculate a potential transfer pricing adjustment?

Proposed Solution

Based on the information included in the transfer pricing documentation and the additional information requested during the audit, the following conclusions were reached:

- For its manufacturing activities, AUTO SRL operates as a contract manufacturer.
- AUTO PCE controls the significant risks associated with the business and has the capacity to make the relevant strategic decisions.
- AUTO SRL performs routine manufacturing functions without strategic responsibilities and should therefore be remunerated accordingly for the functions performed.

According to the OECD Transfer Pricing Guidelines, profits should be aligned with the value created along the value chain.

Given the functional profile of AUTO SRL, the losses recorded during the audited period are not economically justified, as a limited-risk manufacturer would normally earn a positive routine return.

Therefore:

- AUTO SRL is considered a limited-risk manufacturer.
- Using the Transactional Net Margin Method (TNMM) and the selected profit level indicator (PLI), the entire manufacturing activity of AUTO SRL was tested.

Since AUTO SRL recorded losses, an adjustment is proposed to ensure arm's length remuneration by allocating part of the expenses to AUTO PCE, which is considered to control the economically significant risks.

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CASE STUDY 18 – Serbia

Case Submitter:

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Background - Description of the Case:

Company AlfaCo, resident in Country A, is engaged in the distribution of mineral fertilizers both domestically and internationally. It procures goods exclusively from its related party, BetaCo, resident in Country B, which is engaged in the production of mineral fertilizers.

For goods sold in Country A, transportation from the supplier BetaCo to AlfaCo is organized by AlfaCo. Goods sold to foreign markets do not enter the territory of Country A; instead, they are shipped directly from BetaCo to foreign customers, with transportation arranged by BetaCo. The related party (BetaCo) negotiates sales terms with foreign customers, and the tested party, AlfaCo, does not have the ability to influence the agreed sales price.

In its transfer pricing documentation for 2022, AlfaCo applied the Comparable Uncontrolled Price (CUP) method for analyzing the purchase of mineral fertilizers from the related party BetaCo, relying on external market price data. The documentation states that benchmark prices from a reputable fertilizer exchange in Country C were used and adjusted for transportation costs depending on the agreed delivery terms (Incoterms).

The transfer pricing documentation includes a table presenting price ranges for fertilizers. Specifically, for each transaction with the related party, the taxpayer disclosed the minimum and maximum fertilizer prices, projected transportation and packaging costs, adjusted prices, the invoiced price from BetaCo, compliance with the arm's length range by product type (ammonium sulfate, ammonium nitrate, urea, ammonia), as well as the relevant contracts and annexes concluded between the parent company BetaCo and the tested party.

Based on this analysis, the taxpayer concluded that the prices at which BetaCo sells goods to AlfaCo fall within or below the market range, and therefore no transfer pricing adjustments were required in the tax return.

During the tax audit, the taxpayer was requested to provide supporting evidence for the data used in the transfer pricing report. In its response, the taxpayer stated that the term “exchange prices” had been incorrectly used, clarifying that the analysis was actually based on price ranges published

by agencies such as Fertecon, Argus Ammonia, and Profercy Nitrogen, which provide weekly assessed prices (price indications) for mineral fertilizers. These agencies estimate market prices using their own methodologies.

It was observed that price assessments differed across agencies for certain dates, and that the taxpayer did not consistently rely on a single source. Furthermore, the taxpayer did not substantiate the projected transportation costs but instead provided calculations based on its own estimated cost per kilometer.

The taxpayer was also requested to provide, if available, internal comparable data on the prices at which the parent company BetaCo sells fertilizers to independent customers. However, such internal comparables were not provided, allegedly due to confidentiality restrictions imposed by BetaCo.

The commodity exchange in Country A does not trade mineral fertilizers in significant volumes and therefore does not provide representative market prices. Based on the financial data for 2022, AlfaCo achieved a net profit margin of 1.71% from the resale of goods purchased from the related party BetaCo.

Questions (relating to the case)

1. Determine the functions, assets and risks of AlphaCo and BetaCo.
2. Do you think the taxpayer methodology is appropriate, and why?
3. Select the appropriate transfer pricing method.
4. Discuss potential challenges and how to overcome them.

Proposed Solution

Although the taxpayer applied the CUP method, several reliability issues arise — particularly regarding the quality of comparables, consistency of data sources, and lack of supporting documentation. This raises the question of whether a transactional profit-based method would provide a more robust outcome.

During the tax audit, the reliability of the applied transfer pricing method and the supporting documentation was assessed.

It was concluded that the application of the CUP method was not sufficiently reliable in this case.

This conclusion was based on several factors:

- the use of assessed prices rather than actual transaction prices,
- inconsistent use of multiple data sources,
- the absence of internal comparables,
- insufficiently supported adjustments, and
- the fact that the commodity exchange in Country A does not trade mineral fertilizers in significant volumes and therefore does not provide representative market prices.

Given these limitations, the CUP method was rejected and the TNMM was applied as the most appropriate method.

Under the TNMM, AlfaCo was treated as the tested party, taking into account its functional profile as a distributor with limited influence over pricing.

A benchmarking analysis was performed using comparable independent distributors, resulting in

an arm's length range of net profit margins between 2.52% and 6.07%, with a median of 3.52%. It was determined that AlfaCo's achieved net profit margin of 1.71% was below the arm's length range.

Consequently, a transfer pricing adjustment was made to increase the taxable base up to the arm's length level.

The taxpayer filed an appeal against this decision, which is currently under review by the second-instance authority.

This case demonstrates that the application of the CUP method requires highly reliable and consistent comparable data.

In the absence of such data, a transactional profit-based method such as TNMM may provide a more appropriate and defensible result.

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CASE STUDY 19 – Slovakia

Case Submitter:

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Background - Description of the Case:

Case Description

Company SK is a manufacturing company in the automotive industry located in Country SK, operating 6 production plants and 1 non-production facility. The company's core business activities include the manufacturing and assembly of dashboards, car seats, and exhaust systems.

The shareholders of the company are resident in Country A, while the company itself is part of a multinational group with a global parent entity based in Country B. The division of responsibilities between the company and the group for functions and risks is shown in the below tables:

Functions

Function	Company SK	Group
Strategic planning		XXX
Operational management	XXX	X
Research & development		XXX
Procurement	X	XXX
Manufacturing	XXX	
Product testing & quality control	XX	X
Marketing, pricing, sales		XXX
Warehousing & inventory management	XXX	
Logistics & transportation	XX	X
Warranty & claims	XX	X
Human resources	XX	X
Administration, accounting, financing	XXX	XX

Risks

Risk	Company SK	Group
Strategic planning risk	XXX	X
Operational risk	XXX	
R&D risk	X	XXX
Procurement risk	XX	X
Manufacturing risk	XXX	
Testing & quality control risk	XXX	
Marketing, pricing, sales risk	XXX	
Warehousing & inventory risk	XXX	
Logistics & transportation risk	XXX	
Warranty & claims risk	XXX	
HR risk	XXX	
Administration, accounting, financing risk	XXX	
Market risk	XXX	
Credit risk	XX	
Liquidity risk	X	X
Currency risk	X	
Interest rate risk	X	

Significant Controlled Transactions

1. Participation in R&D expenditure (Netto R&D)
2. Purchase of PPA services
3. Acquisition of intangible fixed assets
4. Purchase of management services
5. Purchase of materials for manufacturing own products
6. Sale of finished products
7. Sale of prototype products
8. Purchase of logistics services
9. Sale of services – other recharges
10. Cash pooling

Functional and Risk Characterisation

Based on its functions and risks, Company SK is characterized as a manufacturer, with the final pricing of finished products determined at the group level.

The case concerns transactions involving nominated suppliers. Company SK purchases materials from nominated suppliers under the following process:

- Nominated materials are specified in nomination sheets or negotiation lists agreed with customers.
- The nominated material and its price are pre-agreed between Company SK's supplier and Company SK's customer.
- A nomination agreement (nomination sheet) is concluded between the Group and the supplier.
- The Group agrees with the customer on the final product price, which includes:
 - the purchase price of nominated material,
 - the price of free-sourced material, and
 - the manufacturing (assembly) fee.
- The procured material is subject to warehousing, production processing, and incorporation into the final product using Company SK's tangible assets and know-how.
- Several production plants of Company SK operate on this principle, in some cases with more than 80% of turnover linked to nominated material.
- Comparable companies also manufacture products for the same customer group.

All costs from nominated suppliers are invoiced separately to customers as a distinct line item, with the purchase price equal to the resale price. Company SK argues that no margin should be applied to nominated materials, as the company does not create additional value — all conditions being pre-agreed. According to Company SK, these costs qualify as pass-through costs or "exceptional costs", and therefore should be excluded from the cost base. At the same time, the taxpayer does not propose adjusting the revenue side of the transaction.

However, Company SK bears costs and risks associated with the nominated material, including risks of loss, damage, or impairment during storage, manufacturing, and transportation to customers under agreed delivery terms. The company is the legal owner of both the materials and finished goods. In the event of supplier issues, Company SK must contact the customer, who then initiates corrective negotiations with the suppliers.

Questions (relating to the case)

1. Does your tax administration have experience with the concept of nominated suppliers?
2. Do you have practical experience with pass-through costs?
3. How would you approach this case?
4. In your opinion, should these costs be considered true pass-through costs with no profit element, or should a profit element be recognized? Please provide arguments to support your position.
5. If the taxpayer applies the TNMM method and concludes that these are pass-through costs, is it correct to exclude them only from the cost base, or should both the cost and revenue sides be adjusted accordingly? Do you see a problem with ensuring comparability when processing benchmarking analysis?

Proposed Solution

Based on the findings of the tax administrator, the controlled taxpayer (Company SK) acted as a manufacturer rather than an intermediary during the audited period. The nominated material was subject to storage and production processes, with production inputs incorporated into the supplied material (integration into the final product) through the use of the taxpayer’s assets (tangible property, know-how). The taxpayer incurred costs related to the nominated material and bore the risk of loss, devaluation, or damage to the material during storage, as well as throughout production and transportation to the customer in line with the agreed delivery terms. The controlled taxpayer retained ownership of both the material and the finished products. In the event of an issue with the nominated supplier, it was the taxpayer who communicated with the customer.

Chapter II of the OECD Guidelines also addresses pass-through costs. The definition and potential exclusion of pass-through costs from the cost base must be interpreted in relation to the specific facts of the case. Whether such costs are excluded depends on the extent to which an independent party, under comparable circumstances, would agree not to apply a profit margin to certain costs it bears. The assessment of these costs must also be based on a comparability analysis and the prepared functional and risk profile. Pass-through costs may arise, for example, if the controlled entity operates as an intermediary. In such a case, it would be appropriate to determine the arm’s length price not by applying a mark-up to the service costs as a whole, but rather to the costs linked directly to the intermediary function. For instance, as noted in the OECD Guidelines (para. 7.34), an associated enterprise may incur advertising space rental costs on behalf of group members—costs that the group members would have borne directly if they were independent. In such cases, it would be appropriate to allocate these costs to the group members without a mark-up and apply the mark-up only to the costs incurred by the intermediary in performing its intermediary function.

As follows from the above, the categorization of costs must always be considered in light of the specific circumstances of the case and supported by the results of the prepared functional and risk analysis. At the same time, it is essential to ensure comparability of profitability between associated and independent entities. Therefore, if costs are excluded from the denominator of the net profit indicator, under the arm’s length principle it is also necessary to exclude comparable costs from the denominator of the net profit indicator for comparable companies during the comparability analysis. Based on the available sources, it is not possible to obtain information on the use of nominated suppliers among comparable companies. According to the OECD Guidelines (paras. 3.50 and 3.53), „comparability adjustments should be considered if (and only if) they are expected to increase the reliability of the results“ and “the only adjustments that should be made are those expected to improve comparability.”

Finally, we emphasize that if an adjustment is accepted on the cost side due to “exceptional” expenses, this adjustment must also be reflected on the revenue side.

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CASE STUDY 20 – Slovenia

Case Submitter:

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Background - Description of the Case:

The tax authority conducted a tax audit of corporate income tax (CIT) and an audit related to the identification of beneficial owners for the period from 1 July 2020 to 30 June 2022.

The taxpayer operates under NACE code 27.310 – Manufacture of fibre optic cables. Its core business consisted of the production and supply of products and semi-finished goods exclusively to related parties in the United States and Thailand. The taxpayer is part of a multinational group and performed all key production and supporting functions, except for the central group management and holding functions, which were carried out by the related parent company.

For the transactions involving the sale of semi-finished and finished products, the taxpayer selected the Comparable Uncontrolled Price (CUP) method as the most appropriate method to justify the arm's-length nature of its transfer prices. The tax authority did not agree with this approach, as the taxpayer failed to demonstrate the use of appropriate comparables and did not substantiate the comparability of functions, assets and risks in the compared transactions. Consequently, the tax authority could not accept either the selected method or the prices determined on its basis. The taxpayer was repeatedly requested to adjust the selected method and to provide additional evidence and explanations. However, these requests were not met. Throughout the audit, the taxpayer maintained that the conditions of the transactions during the audited period did not differ from those in 2017, when the taxpayer was acquired by the group, and that the comparison with independent companies from which the group had previously sourced products remained valid.

The tax authority concluded that this position was unfounded. Since 2017, the taxpayer had continuously invested in product development, which significantly altered the conditions of the transactions. These changes affected not only the allocation of assets, functions and risks, but also a key element of comparability — namely, the technical specifications of the products.

From the date of acquisition onwards, the taxpayer consistently reported substantial operating losses, despite having received loans from the controlling company to finance the purchase of raw materials, the acquisition and maintenance of fixed assets, construction costs and investments in real estate, as well as labour and operating expenses. This indicated that the transfer prices applied in the manufacturing transactions had not been determined in advance at a level that would, in accordance with the arm's-length principle, cover the basic production costs, and that the intercompany loans effectively served to finance the taxpayer's ongoing losses.

As a result, the tax authority rejected the CUP method applied by the taxpayer as unsubstantiated and insufficiently supported, and performed its own benchmarking analysis using the Transactional Net Margin Method (TNMM). The analysis showed that, during the audited period, the taxpayer should have achieved at least the following net profit margins (EBIT), adjusted to the median of comparable companies: 3.99% for tax year 2020 (FY 2021, period from 1 July 2020 to 30 June 2021) and 4.36% for tax year 2021 (FY 2022, period from 1 July 2021 to 30 June 2022).

In accordance with the transactional approach, the tax authority applied the median EBIT margins

to the taxpayer's operating revenues and, pursuant to Article 16 of the Slovenian Corporate Income Tax Act (ZDDPO-2), increased the taxpayer's revenues for corporate income tax purposes for both audited tax years.

In assessing the tax liability, the tax authority took into account the carry-forward of tax losses and tax reliefs under Article 55a of ZDDPO-2. Corporate income tax for 2020 and 2021 was assessed together with statutory interest, and additional interest was charged on unpaid advance payments.

As part of the audit, the tax authority also examined intercompany loan transactions, which had not been properly disclosed in the taxpayer's transfer pricing documentation. During the procedure, the taxpayer claimed an accounting error related to the recognition of foreign exchange differences, allegedly arising at the balance-sheet dates of 30 June 2021 and 30 June 2022, due to an amendment to the loan agreement changing the repayment currency from EUR to USD.

It was established that, despite the contractual amendment, the loans, received from a related party in the Netherlands, the taxpayer's 100% shareholder, were actually disbursed in EUR, meaning that the taxpayer was not exposed to foreign exchange risk and therefore had no basis for recognising foreign exchange differences. The tax authority emphasised that financial statements and tax returns must reflect the actual economic substance of transactions, in line with the Slovenian Accounting Standards.

Accordingly, the tax authority did not accept the subsequent recalculations of interest and foreign exchange differences and left the CIT assessments for 2020 and 2021 unchanged in this respect. The taxpayer was instructed to correct the CIT return for 2022, in which foreign exchange differences had been reported.

Questions (relating to the case)

1. When is it justified to reject the CUP method if products and their technical specifications change significantly over time?
2. Can historical comparability from the time of the group acquisition remain relevant if products and production processes are continuously developed?
3. Can an entity that systematically incurs losses and finances them through intra-group loans still be considered a full-fledged manufacturer for transfer pricing purposes?
4. Does long-term financing of losses through related-party loans indicate inadequately determined transfer prices?
5. How important is the assessment of the actual economic substance of transactions when formal contractual arrangements do not reflect the real business model?
6. Is the TNMM more appropriate than CUP in cases of high technical complexity and limited product comparability?
7. Is the use of the median point within the arm's-length range appropriate when the taxpayer reports extremely negative EBIT margins?
8. Can foreign exchange differences be tax-deductible in the absence of actual exposure to foreign currency risk?
9. How should tax authorities treat subsequent amendments to loan agreements changing the currency, when the actual cash flows remain unchanged?

Proposed Solution

The case resulted in a transfer pricing adjustment following a comprehensive tax audit of corporate income tax and related intercompany transactions for the period from 1 July 2020 to 30 June 2022. The tax administration adopted a structured and step-by-step approach, focusing on the economic substance of the transactions and the application of the arm's-length principle.

Procedure and steps followed:

1. Initiation of the tax audit

The tax audit was formally initiated by an audit order covering corporate income tax and related party transactions. The taxpayer was requested to submit complete transfer pricing documentation, intercompany agreements, financial data, and supporting evidence.

2. Review of transfer pricing documentation and functional analysis

The tax administration analysed the taxpayer's transfer pricing documentation, with particular focus on the selected CUP method, the claimed comparables, and the functional, asset and risk profile of the taxpayer. The review revealed that the taxpayer relied on historical comparability and failed to demonstrate sufficient product and functional comparability during the audited period.

3. Requests for clarification and additional evidence

During the audit, the taxpayer was repeatedly requested to adjust the selected transfer pricing method or provide additional evidence supporting the continued applicability of the CUP method. Despite several requests, the taxpayer maintained its original position and did not provide sufficient substantiation.

4. Assessment of economic substance and business model

The tax administration assessed the economic reality of the taxpayer's business model, noting continuous operating losses, extensive product development, and systematic financing of losses through intercompany loans. It was concluded that the applied transfer prices did not cover basic production costs and were not determined in accordance with the arm's-length principle.

5. Rejection of the CUP method

Due to significant changes in product specifications, functions and risks, and the lack of reliable comparables, the tax administration rejected the CUP method as inappropriate and insufficiently supported.

6. Application of TNMM and benchmarking analysis

The tax administration conducted an independent benchmarking study using the Transactional Net Margin Method (TNMM), with EBIT margin as the profit level indicator. Comparable independent manufacturers were identified, and arm's-length median EBIT margins were determined for each audited year.

7. Transfer pricing adjustment

The median EBIT margins were applied to the taxpayer's operating revenues, resulting in an upward adjustment of the tax base for both audited periods, in accordance with Article 16 of the Slovenian Corporate Income Tax Act.

8. Review of intercompany loans and foreign exchange differences

As part of the audit, the tax administration also reviewed intercompany loan transactions. It was established that, despite contractual amendments changing the repayment currency, the loans were actually disbursed in EUR. Consequently, the taxpayer was not exposed to foreign exchange risk, and the recognition of foreign exchange differences was rejected based on the principle of economic substance over legal form.

9. Final assessment and outcome

The final tax assessment included additional corporate income tax, statutory interest, and interest on unpaid advance payments. The taxpayer's objections did not lead to changes in the assessment. The taxpayer was also instructed to correct a subsequent tax return in which foreign exchange differences had been incorrectly recognised.

10. Outcome

The CUP method was rejected as unreliable.

TNMM was applied as the most appropriate method.

The tax base was increased for both audited periods.

Foreign exchange differences related to intercompany loans were disallowed.

The final tax assessment became enforceable.

The taxpayer filed an appeal against the decision. The second-instance authority, the Ministry of Finance, upheld the appeal, annulled the first-instance decision, and remitted the case to the tax authority for reconsideration and re-decision.

IOTA Case Study Workshop “Advanced Transfer Pricing Issues”

29 - 30 April 2026

Budapest, Hungary

CASE STUDY 21 – Spain

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Background - Description of the Case:

1. DESCRIPTION OF THE CASE AND BACKGROUND

1.1. Taxpayer context

Multinational Group A is primarily engaged in the manufacturing and sale of food products. The Group has business units across Europe.

Specifically, in Spain, Group B is established, forming a business unit composed of entities with diverse functions, highlighting the following types:

1. B is the parent company of Group B and carries out marketing and sales functions, as well as providing services.

2. Entities whose primary function is manufacturing, but which also perform marketing and sales activities and may provide services.

Among the various controlled transactions carried out by Group B, the tax inspection team focused on the provision of services known as "INTEGRATED GROUP SERVICES" (hereinafter, IGS). This analysis will focus on this controlled transaction during the years 2020, 2021 y 2022.

2. DEFINITION OF THE CONTROLLED TRANSACTION: provision of IGS services.

The provision of IGS services is carried out through a series of teams referred to as "above-market teams": Supply Chain, Finance, People and Culture, Legal, Business Process Technology, Procurement, Corporate Strategy, Commercial Development, and Public Affairs and Communications.

One of the characteristics of Group A is its decentralized organizational service model. That is, the employees providing IGS services are distributed across the entire European territory and are employed by the different entities comprising the business units of the Group. These employees has different categories like Senior Vice President, Vice President, Director, Senior Manager... Specifically, within Group B, there are employees in our territory providing all IGS services except procurement.

Therefore, business units receive services and can provide services whenever they have staff in their workforce participating in the above-market teams.

The Group A. introduced the IGS service model in 2020. It should be noted that in 2020 and 2021, the IGS fee charged and paid by business units included two components: the basic IGS element and the procurement element. That is, the procurement component, despite being part of the IGS services, was calculated separately in 2020 and 2021.

Regarding service billing, each business unit receiving services receives an invoice that includes the amount to be paid for the total IGS services provided by an entity of Group A located in country M. The entity located in M also receives invoices from all business units that provided services, in order to obtain the remuneration due to them. In short, this entity acts as a pool, issuing and receiving invoices to collect and distribute financial resources.

Within the national scope, B received and issued all the invoices for IGS services. The other entities of Group B, which have employees providing IGS services, invoice B for the salary costs of this employees, without margin.

3. TRANSFER PRICING POLICY

3.1. Analysis of functions, assets and risks

- Above-market teams

In the Transfer Pricing Documentation and contracts, the taxpayer describes the functions performed by each of the teams providing IGS services.

In general, the description is highly generic, focusing on developing and executing strategies, leading projects... Regarding the procurement function, it is specified that they work with the "7 Step Strategic Sourcing" (hereinafter, 7SSP) methodology to improve efficiency and increase savings within Group A.

The main assets of these above-market teams are global account clients and intangible assets (technology). The Vice Presidents of each team along with the CEO are primarily responsible for risk control and management functions.

Therefore, the above-markets services are providers of value added services.

- Business Units

Business units do not provide IGS services, but the Transfer Pricing Documentation specifies that they are the ones responsible for purchasing goods and monitoring the procurement process.

Business units own and use tangible assets (land, buildings, manufacturing assets...) relevant to their daily operations, but they do not possess any intangibles.

Regarding risks, although business units do not manage or control risks, they are the ones bearing the profit and loss accounts, and therefore assume the economic consequences of those risks.

3.2. Valuation of the Controlled Transaction

The taxpayer defines the Transfer Pricing Policy as a variable IGS NET rate (revenue from the provision of all IGS services, including procurement, minus expenses incurred from receiving IGS services). This rate, together with other services⁸ paid by the business unit, has an upper and a lower limit named as cap and floor.

The cap represents the maximum amount a business unit can pay for the IGS NET rate plus expenses related to the Shared Services Center. Specifically, it is set at 4%, 4.3%, and 5% of the business unit's sales for the years 2020, 2021, and 2022, respectively.

If a business unit exceeds the cap, the other business units must make proportional contributions to bring it back within the limit. The proportional distribution used is based on the scorecard used for distributing remuneration to service-providing business units.

The floor aims to ensure that business units achieve, after paying the IGS NET rate and expenses related to the Shared Services Center, an operating profit equal to or above the minimum established. Therefore, this floor referenced to the operating margin of the service-receiving business units and is calculated based on the results of:

- A comparability analysis comparing the operating margins received by comparable companies for manufacturing and distribution activities.
- The historical performance of each service recipient from 2016 to 2019.

All business units are classified into Category A and Category B based on their historical performance (higher and lower, respectively), and accordingly, the Q3 benchmark is applied to those in Category A and Q2 to those in Category B.

Group B is part of Category A, and its minimum limits for the years under inspection were as follows:

2020	2021	2022
7,8%	10%	9%

The taxpayer justifies that adjustments are necessary for the years 2020 and 2021 due to the effects of the COVID-19 pandemic, and therefore the lower limits are adjusted as follows:

2020	2021	2022
5,5%	8,5%	9%

In summary, these would be the minimum percentages that Group B's operating margin must achieve after

⁸ Certain routine or support services outside the IGS services but provided to the entire Group A by a Shared Services Center.

paying the IGS net, routine expenses related to the Shared Services Center, and the cap.

In this case, if a business unit fails to meet the floor, the other business units must also contribute proportionally using the same method used for the cap.

3.3. Transfer Pricing Method used

The taxpayer states that the Comparable Uncontrolled Price (CUP) method is the most appropriate for determining the market-based nature of the NET IGS rate charged to business units, which is then complemented by the Profit Split Method (PSM) to verify that service providers are receiving market-based compensation.

- Comparable Uncontrolled Price (CUP) Method

The selection of the first method (CUP) is justified in the Local Files, noting that franchise agreements are inherently comparable to IGS due to the multiple activities/services provided, as the combined services of the above-market teams are closely intertwined, making it difficult to separate individual transactions.

The analysis starts with a comparability analysis using the Intangible Spring database, selecting franchise agreements. The final benchmark of the comparability analysis is:

Minimum	Q1	Median	Q3	Maximum
4%	5%	6%	6%	12%

The taxpayer selects 7.5% as the most appropriate point within the range, considering that some high-value-added services such as procurement and Business Process Technology are included among the services provided. Therefore, the median of the study is increased by 1.5%.

Additionally, the taxpayer considers that a downward adjustment is necessary because franchise fees typically include the provision of a brand, but in this case, the IGS services do not include brand elements.

To make a downward adjustment, the taxpayer made a new comparability analysis using the Intangible Spring database, focusing on contracts that license the use of brands. The result of this study is the following benchmark:

Minimum	Q1	Median	Q3	Maximum
1,5%	2,75%	4%	4,63%	6%

From this interquartile range, 2.75% is selected, as in franchise contracts, brand owners' total returns are always higher than the simple royalty payment, and the aim is only to eliminate the pure brand effect. From 2.75%, the figure is reduced to 2%, considering that marketing activities have an approximate value of 25% of the brand value.

The taxpayer concludes that the target pricing policy is 5.5% (result of removing 2% from 7.5%). However, since these are the first years of the IGS model's implementation, a conservative approach is preferred, reducing the target price by 1% in 2020 and 2021 and by 0.5% in 2022. Furthermore, due to the effects of the COVID-19 pandemic, an additional downward adjustment is made in 2020 (0.5%) and 2021 (0.2%).

The final result is the following upper limit:

2020	2021	2022
4%	4,30%	5%

That is, the taxpayer sets the cap using the CUP method.

- Profit Split Method

Secondly, the taxpayer considers the Profit Split Method appropriate for highly integrated operations where the parties make unique and valuable contributions to the transaction.

To value the provision of services and remunerate IGS service providers at market prices, the taxpayer uses a scorecard. Specifically, the taxpayer constructs a separate evaluation matrix for the basic IGS services element and another for procurement services, the latter being used in 2020 and 2021.

Thus, to determine the evaluation matrices for IGS, a value chain analysis is conducted, identifying the business functions and specific processes that constitute the activities performed in each business function.

To achieve the so-called scorecard the Group consider the following criteria: employee category, functions performed, and the relative importance of each function. Once all the above criteria are evaluated, the points obtained by each business unit are aggregated, resulting in the scorecard.

Specifically, Group B represented 25% in 2020, 24% in 2021, and 16.5% in 2022. The decrease in 2022 is due to the inclusion of the procurement service within the IGS scorecard.

For procurement, the Group follow a similar process to reach the scorecard corresponding to that service in 2020 and 2021. In this case, Group B had no employees providing procurement services during the inspection years, so this aspect was not evaluated.

4. KEY INFORMATION APPEARS DURING TAX INSPECTION

4.1. Application of the Transfer Pricing Policy

- Basic IGS Element

The business units receiving services paid 2.5% of their third-party sales for IGS services in 2020, 3% in 2021, and 5% in 2022.

The total amount obtained, less the depreciation of intangible assets, amount that entity M keeps, was the amount to be distributed among the service-providing business units.

- Procurement

In 2020 and 2021, when the procurement service fee was calculated independently, it amounted to 3% of the total Group A spend volume (the expenditure managed by the procurement team).

This amount was distributed among the business units based on the cost savings generated by the procurement team's intervention. The taxpayer provided the savings data, but their accuracy could not be verified.

Specifically, the weighted average savings of Group B, according to the information obtained, were 19.16% of the Group's total savings (used for both 2020 and 2021). Therefore, Group B should have paid 19.16% of 3% of the spend volume.

It is also relevant to note that, according to the taxpayer, the savings achieved by the procurement function in Group B were €7 million and €6 million in 2020 and 2021, respectively. In contrast, the payments made by Group B for receiving procurement services in 2020 and 2021 were €34 million and €30 million, respectively.

- Cap and Floor Limits

Group B always remained within the established limits and therefore participated in the contributions required from other business units that were not in the same situation.

4.2. Functional Questionnaires

The tax inspection carried out two extensive functional questionnaires regarding both procurement activities and the basic IGS element.

A brief summary of the responses provided is as follows:

- Procurement Questionnaire: the taxpayer explains that the procurement team uses the 7SSP procedure, stating that the team makes proposals to business units, but the final decision rests with the business units themselves (although in 90%-95% of cases, they follow the team's recommendations). It is confirmed that 7SSP procedure is a standardized process, adapted according to the specific product or service involved.

Therefore, it is clear that the procurement team's function is to apply and drive the 7SSP process to address the need to acquire goods or receive services for one or more business units. It is also demonstrated, by the evidence provided, that these business units are also participants in the process, not only through the acquisition decision-making.

- Basic IGS Element Questionnaire: the taxpayer expands on the information contained in the Transfer Pricing Documentation and contracts, providing documents as proof of service provision. Upon reviewing the documentation and explanations, the provision of services is confirmed, but their significance remains unclear, as the explanations are considered overly extensive but repetitive in relation to the available information.

It is confirmed that business units are responsible for executing the guidelines and standards established by the above-market teams within their respective territories.

In both cases, procurement and basic IGS element services, it is considered that the benefit test is met and that the services are indeed provided.

4.3. Verification of Comparability Analysis

The comparability analysis submitted by the taxpayer contain multiple defects:

- Franchise Comparability Analysis: the search date is not recorded, in most selected comparable the licensee name is missing, the territory where the contract would apply is not specified, the types of agreements and rights licensed are not indicated; and some selected comparable are deemed inappropriate.

- Brand Comparability Analysis: the version of the database used and the date of the analysis are not recorded and the majority of selected comparable were contracts finalized before 2014.

4.4. Key Data

It is relevant to have an approximate reference to the amounts represented by the described transactions:

	2020	2021	2022
IGS Spend	84.000.000	100.000.000	150.000.000
Basic IGS element	50.000.000	70.000.000	150.000.000
Procurement	34.000.000	30.000.000	
IGS Income	62.000.000	70.000.000	105.000.000
NET	-22.000.000	30.000.000	45.000.000

Questions (relating to the case)

- 1) Can IGS services be considered high value-added services?
- 2) Should the application of the cap and floor limits be considered correct according to the taxpayer's characterization?
- 3) Do you consider the transfer pricing methods chosen by the taxpayer to be appropriate?
- 4) If not, how would you value the receipt and provision of these services?

Proposed Solution

- 1) Can IGS services be considered high value-added services?

Based on the analysis of the information gathered through questionnaires and other inquiries directed at the taxpayer, it was determined that the above-market teams carried out supporting functions, as well as developed and communicated guidelines in line with Group A's strategy within their respective specific areas. In turn, these services facilitated the development of capabilities within the business units, ensuring alignment with the global objectives of all business units comprising Group A.

Moreover, it was also established that the business units were responsible for implementing the guidelines communicated by the above-market teams.

It was also verified that the provision of these services did not involve unique and valuable intangible assets. Therefore, according to the functional analysis carried out, the tax inspection concluded that the provision of IGS services constitutes a value-added service satisfying the benefit test referred to in OECD Transfer Pricing Guidelines, section B.1.1. of Chapter VII.

- 2) Should the application of the cap and floor limits be considered correct according to the taxpayer's characterization?

The application of the cap and floor cannot be considered consistent with the arm's length principle for the following reasons:

- Through this instrument, Group A redistributes the income from the provision of IGS services among the business units, after these had already been allocated according to its own methodology.
- For this redistribution, costs associated with the Shared Service Center are taken into account, which are unrelated to the IGS services.
- It is inconsistent with the arm's length principle to use historical operating margins of the business units when applying the floor limit.

- 3) Do you consider the transfer pricing methods chosen by the taxpayer to be appropriate?

- Comparable Uncontrolled Price (hereafter, CUP) Method

The Inspection did not consider the application of the CUP method appropriate because the comparable used had a very different functionality compared to the controlled transaction, and the adjustments made to correct the differences lacked precision and did not contribute to improving the reliability of comparability. Furthermore, it was considered that if the CUP method was intended to determine the net amount of IGS services that each business unit should pay, this objective did not reflect a correct application of the arm's length principle.

The determination of whether the controlled transaction, consisting of the provision or receipt of services, was valued at market terms could not be based on the net amount of both flows, but rather should be established

based on the market value at which an independent entity would provide and receive such services. Therefore, neither the transfer pricing method used, nor the way it was applied, nor the comparability analyses provided were considered to constitute a correct application of the arm's length principle.

- Profit Split Method

Regarding the application of the profit split method, the tax inspection found that it was actually the application of allocation keys (scorecards) to distribute the amount paid by the recipient units of the services. The determination of the scorecard revealed a significant degree of subjectivity in defining the elements and magnitudes that comprise it, and the taxpayer failed to demonstrate that the analysis of contributions from the different roles or categories performed responded to criteria or outcomes consistent with the arm's length principle.

Additionally, the IGS services were not considered unique and valuable contributions (OECD Transfer Pricing Guidelines, paragraph 2.119) nor was the business operation closely integrated (OECD Transfer Pricing Guidelines, paragraph 2.120). Therefore, the application of the profit split method to value the remuneration of the business units was not appropriate.

4) If not, how would you value the receipt and provision of these services? As a result of the tax inspection's rejection of the taxpayer's valuation methodology for determining the market value of the IGS services, the tax inspection proceeded to determine the valuation it considers to comply with the arm's length principle.

Since the above-market teams does not use unique and valuable intangible assets, and reliable comparable have been identified, the market or arm's length value could be determined using a unilateral method (OECD Transfer Pricing Guidelines, paragraph 6.205), specifically the net margin method, following the guidelines established in the OECD Transfer Pricing Guidelines.

The most appropriate profitability indicator would be labour costs, as they best reflect the most important value of the functions performed by the above-market teams. The tested party is the above-market teams. Therefore, to carry out the valuation of the controlled transaction, the tax inspection followed these steps:

1. The cost of employees comprising the above-market teams had to be determined. The taxpayer only provided information on employees located in Group B's business unit. However, through the Exchange of Information on Request's instrument, the countries where the remaining employees were located were queried, obtaining the labour cost of the above-market teams.

2. To identify independent entities providing comparable services to the IGS services, the Inspection conducted a comparability analysis to find comparable entities that performed functions similar to those of the above-market teams in providing IGS services.

However, there was a challenge in the search for comparable; to avoid distortions in valuing the IGS services, the cost structure of the comparable needed to match that of the analysis entity. The above-market teams had predominantly only labour costs and operating (indirect) costs, making it very difficult to find comparable entities. Additionally, the taxpayer was asked to provide operating costs related to the employees forming the above-market teams, but no such information was provided.

Therefore, these costs had to be estimated to obtain a cost structure as close as possible to that of the above-market teams, thus enabling the identification of the most appropriate comparable. To this end, the profit and loss statement of the entity housing the Shared Service Center was used, as it only provided these services, and its cost structure should be comparable to the hypothetical cost structure of the above-market teams.

After analysis, it was verified that the operating costs of this entity amounted to 24% of labour costs in 2020, 20% in 2021, and 29% in 2022. Applying these proportions to the labour costs of the above-market teams allowed for the estimation of hypothetical operating costs.

Thus, the cost structure of the above-market teams was estimated as consisting of labour costs (known), depreciation of assets (known), and operating costs (estimated), enabling the determination that the average ratio of labour costs to total costs for the above-market teams was 60%.

To select comparable with a similar cost structure, and due to the difficulty in finding entities with an identical cost structure, a range of $\pm 20\%$ was applied, resulting in a diagnostic ratio between 40% and 80%. The outcome of the comparability analysis was as follows:

2020

WAVG EBIT/Labour Cost

2017-2019 2021

WAVG EBIT/Labour Cost

2018-2020 2022

WAVG EBIT/Labour Cost

2019-2021

Minimum 4,63% 6,21% 6,23%

Q1 7,61% 7,82% 10,18%

Median 19,61% 21,81% 22,66%

Q3 34,14% 37,20% 38,15%

Maximum 91,55% 106,08% 122,29%

-Application of the transfer pricing method

Applying the transfer pricing method selected by the Inspection to the data provided by the taxpayer revealed that the remuneration received by the above-market teams for providing IGS services fell outside the interquartile range of the market. Therefore, a proper valuation of these services was required. The selected point within the range was the median, in accordance with paragraphs 3.57 and 3.62 of the OECD Transfer Pricing Guidelines.

The tax inspection considered that all IGS services should be valued collectively. Therefore, based on the above information, the calculation of the remuneration cost for the above-market teams was as follows:

1. The total labour cost of above-market teams was increased by a market-based mark-up, which corresponds to the median of the previous comparability analysis.
2. Once the total cost of employees including the mark-up was obtained, depreciation of intangible assets was added, resulting in the total amount that all business units should pay.
3. To allocate the cost among the business units, the allocation key used was the unit cases of each business unit. The unit cases is a measure used by the Group to identify production output per country and was a known data point.
4. Finally, to remunerate the business units providing the services, the cost of employees plus the mark-up had to be distributed. Given that the employees of the above-market teams corresponding to each business unit was known, it was considered most appropriate for each business unit to simply receive its labour cost plus the mark.

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CASE STUDY 22 – Sweden

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Background - Description of the Case:

1 Background and Initiation of the Audit

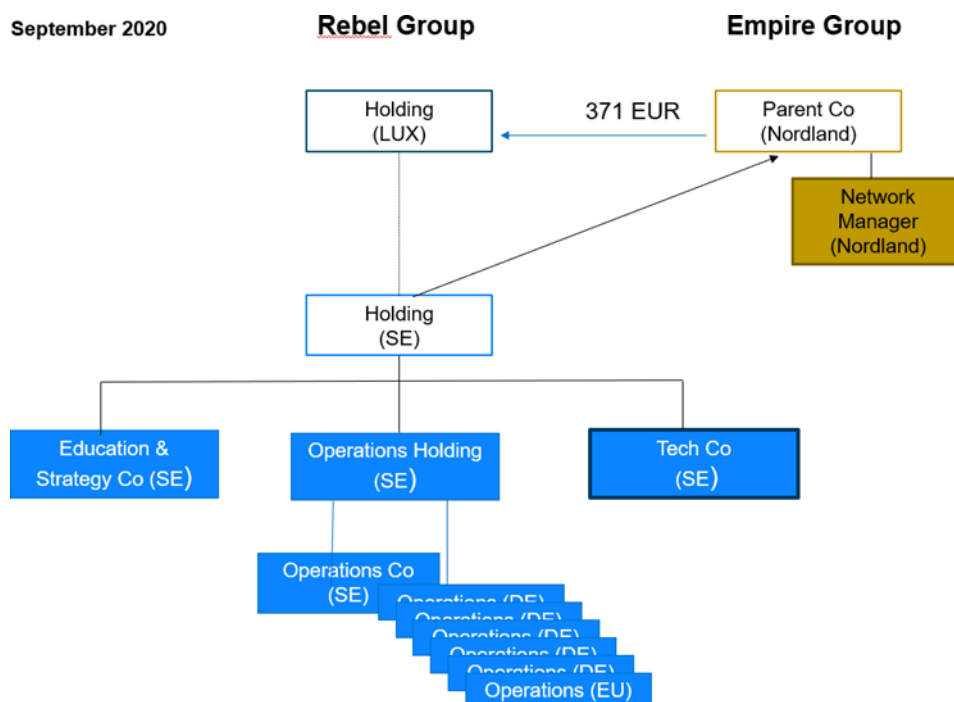
Group context

Rebel Group (SE) a European advanced customer-and tech - services provider, was acquired in September 2020 by Parent Co of Empire Group (Nordland).

Since 2016, Empire group has undergone a comprehensive transformation aimed at becoming an integrated, customer-centred and technology-driven company: "One Company". The objective has been to offer customers seamless and digitalised offerings by consolidating operations and strengthening the technological platform. Technology and digitalisation have been identified as key components in enabling this transformation.

The Empire Group offers a broader range of services, within which Rebel Group's solutions and offerings fit naturally. However, prior to the acquisition, the Empire Group had not been a significant player in this specific area. The strategic motive behind Empire Groups acquisition of Rebel Group was to gain immediate access to Rebel Group's full-service portfolio and the advanced technology that Rebel Group had developed—achieving in one step what would have taken substantial time and investment to build internally.

September 2020



Rebel Group operated across three business areas. The largest was Operations, led by Operations Co (SE), which employed the majority of the Group's staff and housed many of its key managerial roles. The second area, Education & Strategy, led by Education & Strategy Co

(SE), functioned as a smaller specialist unit. The third area, Tech, led by Tech Co (SE), was primarily responsible for developing the Group's technology i.e. Tech IP.

Since 2017, the main strategic focus not only for the Tech business area and Tech Co., but for the entire Rebel Group, had been the development of its modular technological platform — the ForceSync platform (Tech IP).

Following the acquisition, the Rebel Group was gradually integrated (2020-2023) into the Empire Groups Customer & Services division (C&S), led from Nordland by Network Co. Network Co is, according to the groups Transfer Pricing Model, the entrepreneur of C&S, responsible for providing the companies in the C&S services as part of C&S Network as well as for developing and controlling the C&S intellectual property.

Rebel subsidiaries were gradually (2021-2023) transferred and integrated with Empire group companies in each country or divested. The remaining operations in SE were merged into Operation Co (SE). in 2023.

Start of the audit:

A pre-audit review conducted by the Swedish Tax Agency (STA) identified a sharp decline in the operating margin of Operation Co (SE), from 23% in 2021 to 0.8% in 2022. For 2018-2021 the operating margin had been well above 20% for each year.

STA also noted disclosures in Tech Co's 2022 tax return. The disclosures stated that an intragroup cross-border transfer of technological IP had been carried out from Tech Co to a Group entity, Network Co (Nordland).

The disclosures also mentioned a cost-based valuation despite OECD guidance advising against cost-based methods, but such a method was deemed appropriate in this case. Tech Co also argued that restructurings and valuations of intangible assets are difficult tax-law issues and that clear guidance is lacking.

2 Parties, Transaction and Methods

The transaction analysed in this case study:

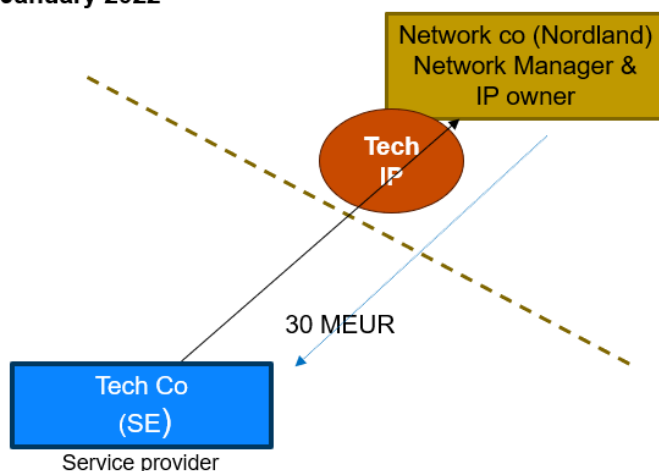
- Transfer of full Tech IP, including associated functions and risks on 1 January 2022.
- Declared value: 30 million EUR.

Tech Co and remaining Rebel entities, were at the same time (Jan 2022) integrated into Empire's transfer pricing model, becoming service providers under the C& S Network with Network Co as the principal. This transition is not discussed further but serves as necessary background information.

Parties:

- Seller: Tech Co. (SE)
- Buyer: Network Co. (Nordland)

January 2022



Method used by Tech Co:

Declared: Cost-based valuation

Actual: Modified PPA-based DCF (relief from royalty) without consideration of goodwill and reducing the royalty rate. No updated benchmark study – thus the same as in PPA.

sep-20		jan-22	
PPA	(MEUR)	Royalty adjustment	Intra Group transfer Price
Goodwill	178		
Customer relationships	91		
Technology/software	44	-14	30
Trade name	4		
Total intangible assets	317		
Tangible and financial assets	11		
Current assets	42		
Total assets	371		
Equity	200		
Total non-current and current liabilities	171		
Total equity and liabilities	371		

3 Audit Approach:

STA evaluated two approaches:

Method 1: Comparable uncontrolled price (CUP) based on the external acquisition of Rebel.

The intra-group transfer took place one year and 4 months after the external acquisition thus the acquisition price may be used as a comparable uncontrolled transaction for determining the internal transfer price of the individual assets transferred in the subsequent intra-group restructuring, in accordance with paragraph 6.147 of the OECD Guidelines.

Impediment:

This applies on the condition that the assets not included in the transfer—the residual business i.e. ongoing concern—can be reliably valued and deducted.

Method 2: Review of the company's PPA-based DCF model.

The accounting values established in a purchase price allocation (PPA) may serve as a starting

point for a transfer pricing analysis (6.29).

Impediment:

OECD Guidelines (paras. 6.29 and 6.155) state that although PPA values may be a starting point, they are generally not reliable enough to determine arm's-length prices for individual assets. OECD Example 22 stresses that the total acquisition price, including goodwill, must be considered and that value does not disappear through internal restructuring.

Questions (relating to the case)

- 1) Relationship between PPA and CUP.
- 2) The role of goodwill in IP-transfers - in the context that no values disappear due to an internal restructuring.
- 3) Benchmark study vs. allocation of the acquisition price, including goodwill
- 4) It is clear from the audit that a large part of the goodwill value is attributable to Tech IP – However, there is no clear basis for allocation based on DEMPE analysis. Is it possible to allocate goodwill proportionally over the identifiable assets recognized in the PPA? Across all assets? Across the intangible assets?

Proposed Solution

STA argued there is a CUP i.e. the external acquisition of Rebel Group.

The intra-group transfer took place one year and 4 months after the external acquisition thus the acquisition price may be used as a comparable uncontrolled transaction for determining the internal transfer price of the individual assets transferred in the subsequent intra-group restructuring, in accordance with paragraph 6.147 of the OECD Guidelines

Method 1:

Comparable uncontrolled price (CUP) based on acquisition price with deductions for values not transferred.

According to the STA, this is the most appropriate and feasible method, provided that the assets not included in the transfer — the residual business, i.e., the ongoing concern — can be reliably valued and deducted from the acquisition price. It is also essential to correctly identify and value the impact of any circumstances occurring between the external acquisition and the internal transfer that may have influenced the value of the asset.

However, given the information available to the STA, it was not possible to calculate the value of the residual business in a reliable manner. Rebel Group consisted of multiple entities operating in different countries, each with varying levels of value contribution, making such a calculation impracticable for STA.

Method 2:

STAs Approach - Review of the company's used DCF based on PPA

As a result, the STA proceeded by analysing the valuation method actually applied by the company — the modified PPA-based DCF model.

This review focused on whether the company's adjustments were consistent with the arm's-length principle and whether they reflected the economic reality of the transaction.

The following assessments were made:

- 1) An analysis of the adjustments made by the company to the asset's value as determined in the PPA.
- 2) An analysis of the validity of the exclusion of goodwill from the valuation. If goodwill is to be included, an analysis of how much of the goodwill should be allocated to the asset.
- 3) An evaluation of whether any increase or decrease in value occurred between the external acquisition and the subsequent intra-group transfer.

STA Assessment:

- 1) Adjustments made by the company:

STA noted that the company's justification for reducing the royalty rate — primarily the argument that the technology would no longer be licensed to external parties — was not aligned with OECD guidance. According to the OECD, value does not simply disappear as a consequence of an internal restructuring, and the allocation of acquisition price in the PPA reflects what independent parties agreed upon in a market transaction. Therefore, any reduction in the value attributed to the Tech IP would logically imply that the value of other assets had increased, unless supported by evidence of genuine economic changes.

STA did not accept the company's adjustment to the asset value as determined in the PPA

- 2) The exclusion of goodwill from the valuation:

According to the OECD Transfer Pricing Guidelines, the valuation of an internally transferred intangible must reflect the full arm's-length value that independent parties would have assigned to that asset in comparable circumstances. This includes not only the value of the identifiable intangible itself, but also any goodwill, going-concern value, or synergies that are economically attributable to the asset.

The OECD emphasises that when independent parties negotiate the price of a business or an intangible, they take into account the incremental value the asset generates in combination with other assets, functions, and risks. This incremental value may be reflected as goodwill or going-concern value and must be included when determining an arm's-length price for the intra-group transfer (OECD TPG paras. 6.147–6.154).

Furthermore, OECD guidance clarifies that goodwill may represent:

- the future economic benefits arising from the asset that are not separately identifiable,
- the asset's contribution to synergies,
- the value generated from its integration with the buyer's existing operations, and
- the enhanced earning potential of the business resulting from the asset.

If such elements are linked to the intangible being transferred, they must be reflected in the transfer price; otherwise, the internal transaction would undervalue the asset compared to what independent parties would have paid (OECD TPG paras. 6.158–6.160).

For this reason, when a PPA or other external information indicates that a significant portion of the acquisition price relates to goodwill connected to a specific intangible (such as technology), this goodwill must be considered when determining the asset's internal transfer price. Ignoring it would contradict the arm's-length principle and fail to reflect the economic reality recognised by independent market participants.

- STA included goodwill attributable to tech IP based on the following facts:
- Both groups had, for several years prior to the acquisition, pursued a strategy focused on digital and integrated solutions.
- Empire's objective is to provide customers with seamless and fully digital processes.
- Access to the technology was an important factor in Empire's decision to acquire Rebel.
- One central strategic motive behind the acquisition of the Rebel Group was to integrate Rebels' modular technology with Empire's existing digital platforms, thereby creating a unified and efficient technological infrastructure. Such integration generates added value both in internal processes and in the services offered to customers.
- After the acquisition, Empire, together with Rebel organisation, worked on further developing the technological platform that Empire had originally built for the European market, transforming it into a global platform accessible to all customers within the Empire Group.
- *"The increase in margins is to a large extent driven by the implementation of the IT system together with synergy effects." (PPA)*
- *"Synergies are mainly driven by the full implementation of the technology/software and therefore not part of the customer relationship revenue."*

3) STA find no evidence to suggest that any decline in value occurred between Empire's external acquisition of the Rebel Group in September 2020 and the subsequent internal transfer on 1 January 2022. On the contrary, the annual reports from both groups indicate that the value of the asset was at least maintained between the two transactions.

Concluding assessment:

There has been no reduction in the value of the technology between the two transactions and the adjustment made by the company i.e. the royalty rate does not result in a more accurate arm's-length price.

It is clear that a significant part of the goodwill value is attributable to the Tech IP. STA assessed that the tangible assets did not contribute to synergies or otherwise to any goodwill value. However, it cannot be ruled out that there is also significant goodwill components associated with other intangible assets, mainly the operational as well as the processes and expertise developed within Operations and Education & Strategy.

To ensure that the allocation reflected economic substance, the STA distributed the goodwill value in proportion to each identifiable intangible asset's relative share of the total intangible asset base. Based on the fact that the Tech IP had been assigned a substantially lower value in the PPA than the assets—particularly the customer relationships within the operational business—the STA adopted a cautious and conservative approach. This method was selected given a more precise allocation basis could not be established with the information available to the STA.

The adjustments resulted in a monetary increase in the transfer price of 70.3 MEUR + tax surcharge.

The adjustments consist of:

Non-acceptable adjustments: 14 MEUR

attributable goodwill: 56,3 MEUR

The company's position:

The company maintains that the price in their internal valuation is arm's-length and that the benchmarking study should form the basis of the transfer pricing analysis. They also argue that the entire range identified in the benchmarking study reflects arm's-length prices.

The case is not settled in court.

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Budapest, Hungary

CASE STUDY 23 – Ukraine

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Background - Description of the Case:

The case concerns the activities of the Ukrainian company 'U', a subsidiary of the international group 'O', which forms part of a media and internet holding company with its parent company 'P' (South Africa). The group operates in the field of e-commerce and online classifieds platforms and is active in more than 60 countries worldwide.

The Ukrainian company operates in the field of online advertising and electronic services, ensuring the functioning of the local version of the international classifieds platform. The company employs around 160 staff, with its core activities being advertising agencies and online marketing.

The financial holding company 'N' (Netherlands) plays a key role within the group's structure; it acts as the franchisor for the operating companies in Europe and grants rights to use the business concept, trademark, software and technologies. The Ukrainian company acts as a franchisee and pays franchise fees (royalties and other payments) to the holding company.

Between 2016 and 2022, the total value of controlled transactions relating to such payments amounted to approximately US\$62.3 million, a significant portion of which was attributable to royalties for the use of trademarks, domain names, software and technologies, as well as for IT support, advertising and consultancy services.

Under the terms of the franchise agreement, the Ukrainian company paid a fee calculated as a percentage of gross profit. At various times, the rate of the total franchise payment was:

- 35% (2016–2017);
- 25% (2018–2022).

The payment structure included:

- royalties for the use of the trademark and domain name;
- royalties for the use of technology and software;
- payment for access to software;

- payment for business knowledge transfer services.

At the same time, an analysis of the transactions revealed that the Ukrainian company was simultaneously purchasing IT and e-commerce services from related non-residents, which, in terms of their functional content, may partially duplicate the services included in the franchise fees.

In particular, these services include:

- content moderation;
- user support;
- content processing;
- ensuring the platform's information security.

The total expenditure on the procurement of such services for the period 2015–2022 amounted to approximately US\$40.7 million, representing around 49% of the company's controlled transactions.

Furthermore, between 2019 and 2021, dividends totalling approximately US\$47 million were paid to non-resident entities within the group, indicating a significant redistribution of financial flows in favour of the group's foreign companies.

Thus, within the scope of this case, transfer pricing risks arise in connection with:

- substantial royalty payments to a non-resident related party;
- possible duplication of functions and services that are paid for separately;
- the concentration of intellectual property rights within a number of the group's foreign companies;
- the redistribution of profits from the Ukrainian business segment to the group's foreign companies.

These circumstances require a detailed functional and economic analysis to verify that the terms of the controlled transactions comply with the arm's length principle.

Questions (relating to the case)

1. Economic justification for royalty payments

- Does the overall level of franchise payments (25–35% of gross profit) comply with the arm's length principle?
- Does the structure of payments (royalties for trademarks, software, technologies, exchange of business knowledge) correspond to the economic substance of the transaction?
- Does this payment structure lead to the artificial withdrawal of a significant portion of profits from Ukraine?

2. Determining the owner and creating value of intangible assets

- Who actually performs DEMPE functions (development, enhancement, maintenance, protection, exploitation) in relation to the brand, technologies and software?
- Does the legal ownership of intangible assets (the Netherlands) correspond to the actual place of their creation and development?
- Is part of the value of the brand and platform created by the activities of the Ukrainian company (users, content, local market)?

3. Feasibility of applying the Profit Split method

- Is the Profit Split method the most reasonable method for analysing these transactions?
- Do the parties actually perform interrelated unique and significant functions that justify the application of this method?
- Could the Ukrainian company perform routine functions for which TNMM would be more appropriate?

4. Distribution of functions and risks between group companies

- Does the functional profile of the Ukrainian company (160 employees) correspond to its declared franchisee status?
- Does the Ukrainian company perform key operational functions (marketing, platform development, customer acquisition) that create the bulk of the business value?
- Does the distribution of profits correspond to the actual distribution of functions and risks?

5. Duplication of services within the group

- Is there any duplication of IT services and e-commerce support that are simultaneously:
 - o purchased from a related non-resident company;
 - o performed by a Ukrainian company or local contractors?
- Do such services meet the benefit test criterion (does the Ukrainian company receive a real benefit from these services)?
- Are any of these services shareholder activities or stewardship services, which should not be paid for?

6. Justification of the financial holding company's profitability level

- Is the financial holding company's profitability (143% – 266%) economically justified?
- Does this level of profitability correspond to the functions of a holding company, which actually acts as a franchisor?

7. Group structure and possible tax motives

- Does the creation of an intermediate holding company in the Netherlands have sufficient economic substance?
- Is this structure being used for tax planning and profit accumulation in a favourable jurisdiction?

8. Interrelation between royalties and dividends

- Is a combination of royalties and dividend payments used to optimise the tax burden?
- Do significant royalties lead to a reduction in the taxable profit of a Ukrainian company, after which part of the funds is additionally paid out in the form of dividends?

9. Justification for changes to the terms of the franchise agreement

- Why was the structure of franchise payments changed in 2018 (from 35% to 25%)?
- Were these changes related to:
 - o market factors;
 - o a change in functions;
 - o or tax considerations?

10. The role of the Ukrainian market in creating platform value

- How significant is the contribution of the Ukrainian market (users, content, network effect) to the creation of platform value?
- Should part of the profit remain in Ukraine as compensation for the creation of local value?

Proposed Solution

1. Reclassification of part of the franchise payments

Given that the payment structure provides for several types of remuneration (royalties for the trademark, technology, software and exchange of business knowledge), it is advisable to consider reclassifying part of the payments if it is established that:

- part of such services is not actually provided or is duplicated;
- certain payments actually compensate for the same function.

In this case, it is possible to recognise part of the payments as not complying with the arm's length principle and exclude them from expenses.

2. Adjusting the royalty rate

Given the high aggregate level of franchise fees, one possible approach is to review the market royalty rate.

This may involve:

- determining the market range of royalty rates for similar business models;
- establishing an economically justified share of remuneration for the use of the brand and technologies.

If the market level is exceeded, the taxpayer's financial result may be adjusted.

3. Review of the transfer pricing method used

Since most of the transactions were analysed using the profit split method, it is advisable to consider the possibility of:

- assessing the feasibility of using an alternative method, in particular TNMM;
- determining the routine level of profitability for the Ukrainian company as the group's operating company.

This approach may result in a different profit split between the parties.

4. Adjustment of expenses in case of duplication of intra-group services

Given that the Ukrainian company:

- simultaneously purchases IT services from a related non-resident company;
- and performs similar functions using its own resources or through local contractors, the issue of excluding part of the cost of such services from expenses may be considered if their duplication is established.

5. Redistribution of part of the profit in favour of the Ukrainian company

If the analysis shows that:

- the Ukrainian company performs significant operational functions,
- creates a significant part of the business value in the local market, the possibility of redistributing part of the profit in favour of the Ukrainian company may be considered.

6. Use of information obtained through international exchange

After receiving a response to a special request to the competent authority, it is possible to:

- confirm or refute the functional role of non-resident companies;
- assess the economic substance of the holding structure;
- verify the compliance of the level of profitability with the functions of a non-resident.

This can be used as additional confirmation of the tax authority's position.

Generalised possible outcome of the case review

Based on the analysis, the possible consequences may include:

- adjustment of the royalty rate;
- exclusion of part of the payments for services from expenses;
- revision of the transfer pricing method applied;
- redistribution of part of the profit in favour of the Ukrainian company.