

# ADIT June 2019 Exam

---

## THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2019

---

### MODULE 3.03 – TRANSFER PRICING OPTION

---

ADVANCED INTERNATIONAL TAXATION  
(THEMATIC)

---

TIME ALLOWED – 3¼ HOURS


---

This exam paper has three parts: Part A, Part B and Part C.

You need to answer five questions in total.

You must answer:

- Both questions in Part A (25 marks each)
- One question from Part B (20 marks)
- Two questions from Part C (15 marks each)

Johann H. Müller,  
International tax professional 

## PART A

You are required to answer BOTH questions from this Part.

1. Cradle Group is listed on the New York Stock Exchange. It operates as a multinational group through wholly owned subsidiary companies located in several jurisdictions. The principal operations of the group encompass the design, manufacture and distribution of information technology-related products.

The group owns intellectual property (IP) for the products which it sells. The IP encompasses licences, patents and trademarks relating to the group's brand names, technology and manufacturing processes. The group is a market leader for particular IT products, which sell at a premium price point compared to rival products. The group has expended significant funds in research and development and building its brand over more than twenty years, and this is the principal reason why the group's products are well known and market leading.

The group sells its products through its own retailers; to wholesalers in markets where it does not have a retail presence; and through the internet.

Certain functions are centralised within particular group companies. Such functions include research and development, brand development, procurement, logistics, transportation and other services.

The group's management has summarised the key functions carried out by the most significant group companies as follows:

<u>Jurisdiction</u>	<u>Key functions/assets</u>
Alexus	Operates retail outlets with sales being to independent customers in Alexis.  Sells to independent wholesalers in Alexis.  Legal ownership of worldwide IP rights.  Provides managerial and technical services to associated enterprises.

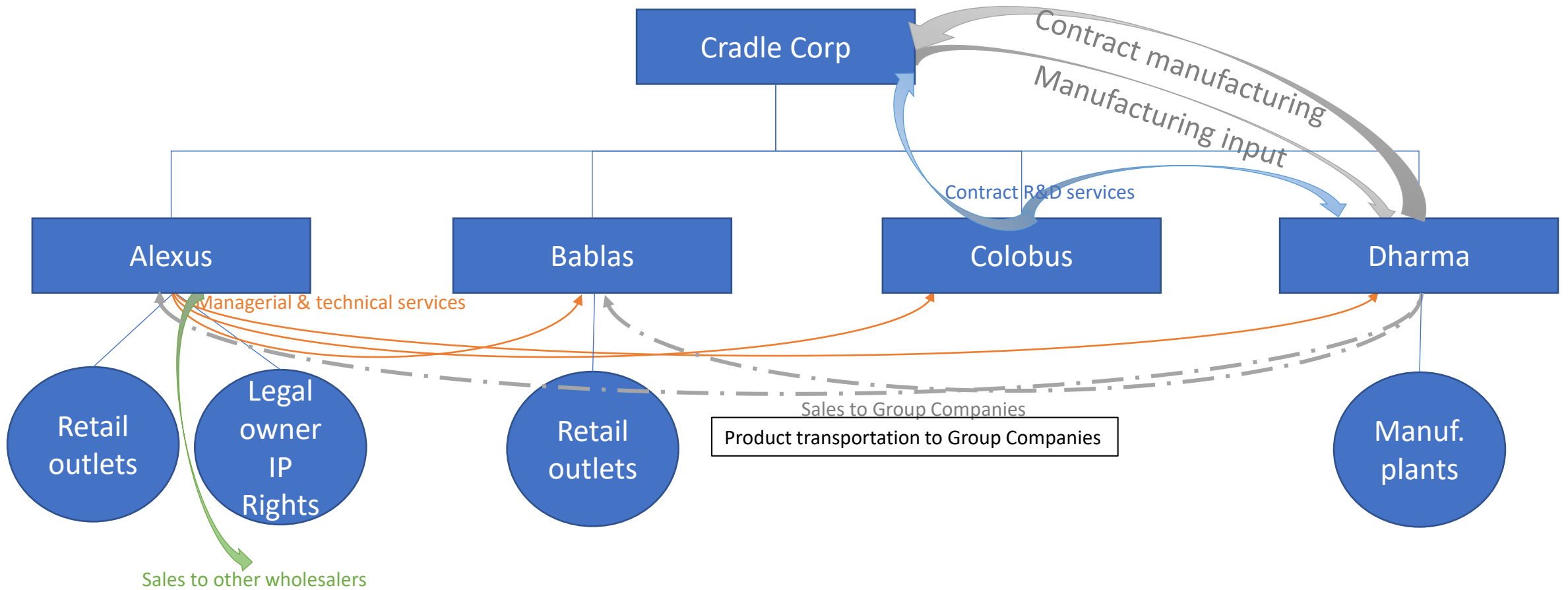
Bablas	Operates retail outlets with sales being to independent customers in Bablas.
Colobus	Conducts contract research and development for associated enterprises.
Dharma	Conducts sales to all associated group entities.  Conducts contract manufacturing.  Procures inputs for manufacturing process.  Arranges transportation of finished manufactured products.

The following table details key financial information for the group's operating entities in the 2018 calendar year. The information is also representative of the 2014 to 2017 calendar years.

<u>Jurisdiction</u>	<u>Tax rate</u>	<u>Net profit to sales margin</u>	<u>Net profit as % of total assets</u>	<u>Sales to independent customers</u>	<u>Number of employees</u>
Alexus	30%	-2%	-5%	\$150 million	2,000
Bablas	25%	1%	1%	\$60 million	1,000
Colobus	20%	88%	150%	\$0	2
Dharma	15%	46%	78%	\$0	25

You have been approached by the group's board of directors, to provide transfer pricing advice in relation to the arrangements described. Your advice should be accompanied by appropriate references to the July 2017 OECD Transfer Pricing Guidelines.





Tax rate:	30%	25%	20%	15%
Net profit/Sales	-2%	1%	88%	46%
Net profit/Assets	-5%	1%	150%	78%
Sales to 3 <sup>rd</sup> parties	\$ 150 mio	\$60 mio	0	0
Nr. of employees	2,000	1,000	2	25

- The group owns intellectual property (IP) for the products which it sells: licenses, patents, trademarks, technology and manufacturing processes.
- The group is a market leader for particular IT products, which sell at a premium price point compared to rival products.
- The group has expended significantly in R&D and brand building over twenty+ years. This is why its products are well known and market leading.

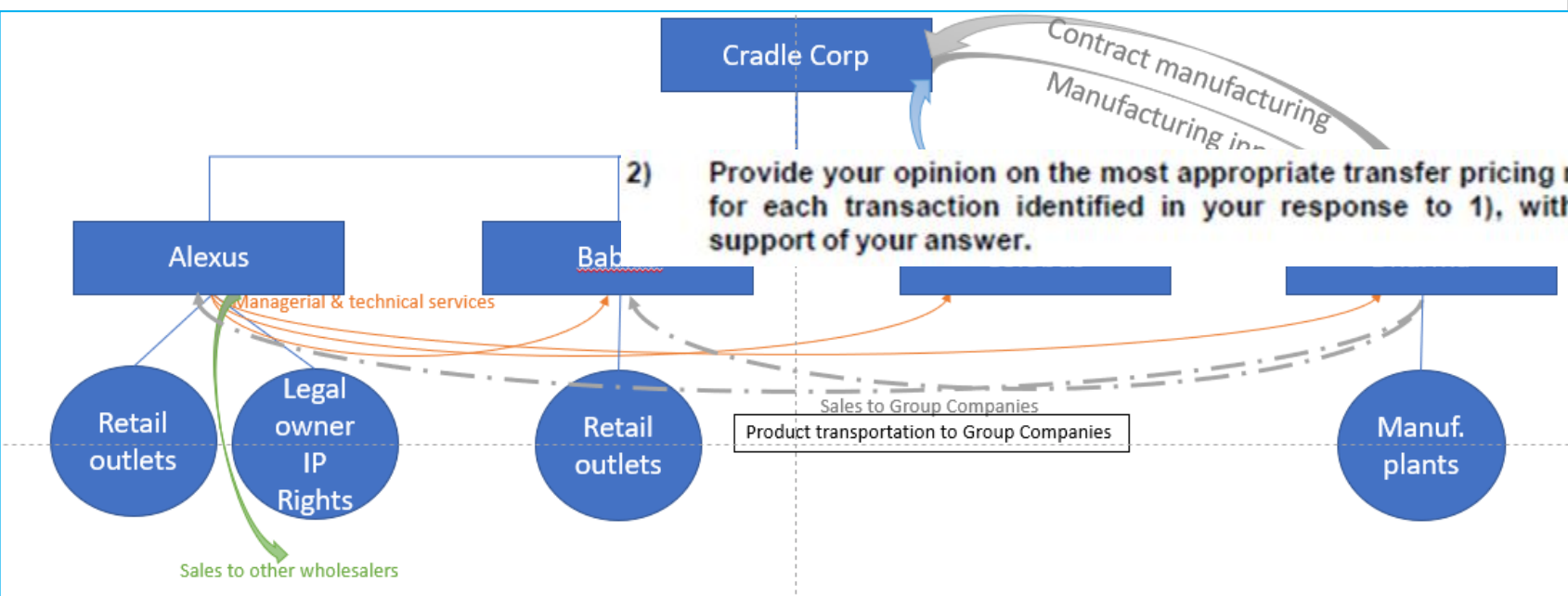


**You are required to:**

- 1) Identify all of the cross-border transactions between associated group enterprises. (5)
  - 2) Provide your opinion on the most appropriate transfer pricing methodology for each transaction identified in your response to 1), with reasons in support of your answer. (15)
  - 3) Identify the most significant transfer pricing risks within the group, with regard to the arm's length principle. (5)
- Total (25)**

Transactions:

1. Alexis provides management & technical services
2. It most likely licenses Intangibles to group Cos
3. It buys its products from Dharma, etc.
4. Bablas buys products from Dharma, etc.
5. It may pay management & technical fees
6. It may pay license fees
7. Colobus provides contract R&D services. With 2 FTEs only, these are not likely to be substantial.
8. It may pay management & technical fees
9. Dharma sells products to group Cos
10. It performs contract manufacturing services
11. It acquires manufacturing input
12. It may pay management & technical fees
13. It may pay license fees
14. Group Cos may finance part of their activities through intercompany loans



2) Provide your opinion on the most appropriate transfer pricing methodology for each transaction identified in your response to 1), with reasons in support of your answer. (15)

Tax rate:	30%	25%	20%	15%
Net profit/Sales	-2%	1%	88%	46%
Net profit/Assets	-5%	1%	150%	78%
Sales to 3 <sup>rd</sup> parties	\$ 150 mio	\$60 mio	0	0
Nr. of employees	2,000	1,000	2	25

- The group owns intellectual property (IP) for the products which it sells: licenses, patents, trademarks, technology and manufacturing processes.
- The group is a market leader for particular IT products, which sell at a premium price point compared to rival products.
- The group has expended significantly in R&D and brand building over twenty+ years. This is why its products are well known and market leading.



You are required to:

1) Identify all of the cross-border transaction enterprises.

PART A

Question 1

Part 1

The key transactions between associated enterprises in the Cradle group are:

Alexus

- Purchase of finished goods from Dharma (or possibly not a purchase transaction depending on clarification of facts regarding contract manufacturing arrangement with Dharma).
- Provides intellectual property to Dharma.
- Provides technical and managerial services to Bablas.
- Provides technical and managerial services to Colobus.
- Provides technical and managerial services to Dharma.
- Receipt of research and development services from Colobus.
- Grants Dharma the right to contract manufacture for group.

Bablas

- Purchase of finished goods from Dharma or possibly Alexis or possibly not a purchase transaction depending on clarification of facts regarding contract manufacturing arrangement with Dharma).
- Receipt of technical and managerial services from Alexis.

Colobus

- Performs Research and Development for Alexis.
- Receipt of technical and managerial services from Alexis.

Dharma

- Sale of finished goods to Alexis and Bablas (or possibly not sales transaction depending on clarification of facts regarding contract manufacturing arrangement with Alexis).
- Use of intellectual property from Alexis.
- Receipt of technical and managerial services from Alexis.
- Performs contract manufacturing for Alexis.

Transactions:

1. Alexis provides management & technical services
2. It most likely licenses Intangibles to group Cos
3. It buys its products from Dharma, etc.
4. Bablas buys products from Dharma, etc.
5. It may pay management & technical fees
6. It may pay license fees
7. Colobus provides contract R&D services. With 2 FTEs only, these are not likely to be substantial.
8. It may pay management & technical fees
9. Dharma sells products to group Cos
10. It performs contract manufacturing services
11. It acquires manufacturing input
12. It may pay management & technical fees
13. It may pay license fees
14. All group Cos may finance part of their activities through intercompany loans

Answer-to-Question- 1\_

Part A

1) Identify the cross border transactions between associated groups:

Managerial and technical services are provided to associated enterprises

Contract R and D is undertaken in Colobus for other associated enterprises

Sales are made from Dharma to other group entities

Procurement is made in Dharma. Not clear if this is cross border or not.

Goods are transported from Dharma, so likely to involve cross border transaction for transport costs, insurance, customs.

- The group owns intellectual property (IP) for the products which it se
- The group is a market leader for particular IT products, which sell at
- The group has expended significantly in R&D and brand building over





You are required to:

1) Identify all of the cross-border transaction enterprises.

PART A

Question 1

Part 1

The key transactions between associated enterprises in the Cradle group are:

Alexus

- Purchase of finished goods from Dharma (or possibly not a purchase transaction depending on clarification of facts regarding contract manufacturing arrangement with Dharma).
- Provides intellectual property to Dharma.
- Provides technical and managerial services to Bablas.
- Provides technical and managerial services to Colobus.
- Provides technical and managerial services to Dharma.
- Receipt of research and development services from Colobus.
- Grants Dharma the right to contract manufacture for group.

Bablas

- Purchase of finished goods from Dharma or possibly Alexis or possibly not a purchase transaction depending on clarification of facts regarding contract manufacturing arrangement with Dharma).
- Receipt of technical and managerial services from Alexis.

Colobus

- Performs Research and Development for Alexis.
- Receipt of technical and managerial services from Alexis.

Dharma

- Sale of finished goods to Alexis and Bablas (or possibly not sales transaction depending on clarification of facts regarding contract manufacturing arrangement with Alexis).
- Use of intellectual property from Alexis.
- Receipt of technical and managerial services from Alexis.
- Performs contract manufacturing for Alexis.

Transactions:

1. Alexis provides management & technical services
2. It most likely licenses Intangibles to group Cos
3. It buys its products from Dharma, etc.
4. Bablas buys products from Dharma, etc.
5. It may pay management & technical fees
6. It may pay license fees
7. Colobus provides contract R&D services. With 2 FTEs only, these are not likely to be substantial.
8. It may pay management & technical fees
9. Dharma sells products to group Cos
10. It arranges transportation of finished goods
11. It performs contract manufacturing services
12. It acquires manufacturing input
13. It may pay management & technical fees
14. It may pay license fees
15. All group Cos may finance part of their activities through intercompany loans

Answer-to-Question-1\_

Part A

1) Identify the cross border transactions between associated groups:

Managerial and technical services are provided to associated enterprises

Contract R and D is undertaken in Colobus for other associated enterprises

Sales are made from Dharma to other group entities

Procurement is made in Dharma. Not clear if this is cross border or not.

Goods are transported from Dharma, so likely to involve cross border transaction for transport costs, insurance, customs.

- The group owns intellectual property (IP) for the products which it se
- The group is a market leader for particular IT products, which sell at
- The group has expended significantly in R&D and brand building over

