A REVIEW OF TRANSFER PRICING CASE LAW

A Comparative Study of Court Decisions on Transfer Pricing (2012-2018)

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BURDEN OF PROOF

PROOF: FRANCE VS. MICROSOFT, FEBRUARY 16, 2012

- In the Microsoft case, the distribution activity of a French subsidiary of an American group was transferred to its Irish sister company. Then French subsidiary was then converted into a sales agent of the Irish subsidiary.
- The commission rate earned by the French subsidiary was reduced from 25% to 18%. The French tax authorities, taking into account the previous 25% commission rate, considered that it should not have been reduced and reinstated the corresponding income into the French company´s taxable income.
- To support their position, the French tax authorities conducted a benchmarking study. However, the Court of Appeals ruled that the mere fact the commission rate had been reduced did not demonstrate the transfer of profits abroad.
- Moreover, the Court confirmed that the transfer of profits abroad was not proved due to the irrelevance of the methods used and of the comparables found by the French tax authorities.
- The companies were not suitable for comparison because they were not in the same market as Microsoft France and that some of them were not independent companies.

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PROOF: SWITZERLAND VS. CORPORATION, JULY 6, 2012

- In this ruling, the Swiss Federal Supreme Court comments on the application of the arm´s length principle and the burden of proof in Switzerland.
- Swiss Law does not have any actual group law and treats each company as a legally independent entity with its own bodies which have to transact the business in the interest of the company and not in that of the group, other companies or the controlling shareholder. Legal transactions between such companies are therefore to be conducted on the same terms as they would be agreed with external third parties.
- Regarding non-cash benefits, the rule is that the tax authority is responsible for proving that the company has rendered a service and that it has no or unreasonable consideration in return.
- If the tax authority demonstrates such a mismatch between performance and consideration, the taxable company shall rebut the presumption; otherwise, it shall bear the tax consequences.
- The Federal Supreme Court disallows transfer of tax losses where the absorbed subsidiary is an empty shell without any economic activity.

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PROOF: ITALY VS. TAKE TWO INTERACTIVE ITALIA, JULY 13, 2012

- The Italian subsidiary of a multinational group dedicated to the exclusive marketing of the groups´ software products (videogames) was charged by a UK sister company an invoice referred to as "Price adjustment to products sold during the fiscal year", on the last day of FY.
- The Italian tax authorities challenged the operation claiming it was evasive, and addressed to reducing the taxable profit of the Italian company by the abusive use of transfer pricing.
- The Italian Supreme Court established that transfer pricing legislation is included among the anti-avoidance provisions, as it is addressed to fight the transfer of income from one country to another by "manipulating" the intra-group costs. Consequently, the burden of proof lies with the Italian tax authorities, which should prove the grounds for the adjustment.
- However, as the sharing of intra-group costs also involves the matter of whether the costs exist and are pertinent, the burden of proof of the costs lies with the taxpayers, says Supreme Court.
- The Italian Supreme Court have drawn a distinction between cases regarding income, and cases regarding expenses. In cases regarding income, the burden of proof lies with the tax authorities. In cases regarding costs, the burden of proof lies with the taxpayer.

PROOF: SPAIN VS. BICC CABLES, JULY 18, 2012

- An adjustment was made by the Spanish tax authorities based on the non-recognition of the tax effects of a series of related-party transactions as part of a leverage acquisition of shares.
- The Spanish Supreme Court found that the transaction would not have been agreed by independent companies and accordingly the transaction in question was not performed in accordance with the arm´s length principle.
- Moreover, the Spanish Supreme Court understood that the way in which the shares of the US parent company had been acquired, the financing of it, the agreed remuneration and the subsequent transfer of shares to the related entity shows, beyond any reasonable doubt, that the transaction was forced upon the Spanish subsidiary by the group parent company.
- Finally, the Spanish Supreme Court concluded that when a transaction is “inherently startling”, it is the party making the transaction the one that must justify the reasonableness despite the appearance of it. In this case, proof was not even attempted by the taxpayer.

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PROOF: SWITZERLAND VS. CORPORATION, JANUARY 15, 2015

- In this case, the Swiss Court elaborates on the application of the arm´s length principle.
- The question of whether there is a disproportion between the service provided by the company and the compensation it provides is determined by comparison with what had been agreed between independent persons (*“Drittvergleich”*).
- The question is whether the benefit would have been granted, to the same extent, to a third party outside the company, or to check whether the “arm´s length” was respected.
- This method makes it possible to identify the market value of the property transferred or the service rendered, with which the counter-benefit actually required must be compared.
- The formation of the price can indeed be influenced by several elements, such as market conditions, contractual conditions (the existence of secondary benefits, the quantity of goods sold, terms of payment), the commercial strategy or the economic functions of the parties.
- The price charged in a comparable transaction is presumed to correspond to the the market price; in case of dispute, proof to the contrary lies with the company.

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PROOF: UNITED STATES VS. GUIDANT CORPORATION, FEBRUARY 29, 2016

- U.S. Income Tax Regulations require that the Commissioner determines the arm´s length consideration for each controlled transaction by using the most reliable method or means under the circumstances.
- U.S. Income Tax Regulations let the Commissioner aggregate two or more separate transactions to the extent that aggregation serves as the most reliable means of determining the arm´s length consideration for the transactions.
- U.S. Income Tax Regulations add that the combined effect of two or more transactions may be considered if such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is the most reliable means of determining the arm´s length consideration for the controlled transactions.
- Petitioners argue that the Commissioner may not aggregate separate transactions involving tangibles, intangibles, or services. The Court disagrees. The regulations let the Commissioner.
- U.S. Income Tax Regulations indicate generally that an arm´s length result may be calculated by separately applying one or more methods in the case of interrelated transactions.

PROOF: FRANCE VS. SOCIÉTÉ LIFESTAND VIVRE DEBOUT, APRIL 15, 2016

- In this case, the Court considered that there was economic control in a situation where the rent for Swiss premises used by a Swiss entity was paid by a French company.
- The functions related to the activity of the Swiss company were actually performed by the French company. Moreover, the French manager managed the Swiss company.
- Consequently, the transactions conducted between these two entities needed to comply with the arm´s length principle and other transfer pricing rules.

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TRANSFER PRICING METHODS

TP Methods: Australia vs. SFN, June 24, 2011

- The case concerned whether the taxpayer paid more than the arm's length price for products acquired from overseas related parties so that the Commissioner could apply the transfer pricing rules to adjust the purchase price for income tax purposes.
- The taxpayer was a member of a global group whose headquarters are in France. The taxpayer bought certain chemicals from group companies overseas, and sold them to unrelated end-users in various industries in Australia. From its incorporation in 1990 until 2004, the taxpayer consistently returned tax losses.
- The taxpayer was subject to a transfer pricing audit. Determinations were made to adjust the consideration for the company's international related party transactions to reflect an arm's length amount. For the income years from 1997 to 2003, the Commissioner made determinations as to the arm's length price of the chemicals.
- The Commissioner issued notices of assessment in 2007, and subsequently disallowed the taxpayer's objections to those assessments.
- The taxpayer produced evidence of sales by the overseas suppliers to third party purchasers, which submitted to establish comparable uncontrolled prices (CUP) that were as high as or higher than the prices paid by the taxpayer.

TP Methods: India vs. Fulford (India), July 4, 2011

- Fulford India Ltd. Imported active pharmaceutical ingredients (APIs) from related group companies and sold them in India. The TNM method was used for determining transfer prices.
- The tax administration found the CUP method to be the most appropriate.
- Fulford India argued that the CUP method requires stringent comparability and any differences which could materially affect the price in the open market should be taken into consideration. In the pharmaceutical world, APIs with similar properties may still be different in relation to quality, efficiency, impurities, etc. Therefore, the two products cannot be compared.
- In court, Fulford disclosed that it also performed secondary manufacturing functions, converting the APIs into formulations. Hence, Fulford could be described as a value added distributor.
- The Court concluded that the selection of the best method should be based on functional analysis and the characterization of transactions and entities.
- The fact that Fulford had secondary manufacturing activities had not previously explained to the tax authorities. Accordingly, the case returned to tax administration for a revised assessment.

TP Methods: Canada vs. GlaxoSmithKline, October 18, 2012

- The Canadian Supreme Court rules in the case of GlaxoSmithKline Inc. regarding the intercompany prices established in purchases of ranitidine, the active ingredient used in the anti-ulcer drug Zantac, from a related party.
- The Supreme Court partially reversed an earlier determination by the Tax Court, upholding a determination by the Federal Court of Appeals in its conclusions that if other transactions are relevant in determining whether transfer prices are reasonable, these transactions should be taken into account.
- However, the Supreme Court did not determine whether the transfer pricing method used by GlaxoSmithKline Inc. was reasonable, and instead remitted the matter back to the Tax Court.

TP Methods: Italy vs. SGL Carbon Spa, September 25, 2013

- This case is about arm´s length interest on loans, use of the comparable uncontrolled price method (CUP), and use of internal and external comparables.
- The Supreme Court stated that the relevant market for comparability is that of the seller.
- The decision was based on the concept of "normal value" as provided by Italian regulations.
- Reference was made to the part of the definition which states: *"In determining normal value, reference must be made – to the extent possible – to price lists or tariffs of the party which has supplied the goods and services or, if necessary, to the indices and price lists of the Chamber of Commerce and to professional tariffs, taking normal discounts into account".*
- The Court ruled in favor of the tax administration.

TP Methods: Finland vs. Corporation, February 4, 2014

- In this case, a series of transfers of shares among related companies took place, and the tax office in Finland raised the income of the seller on the grounds that the price used in the transaction was considered below the share´s market value. Further, a tax increase was applied
- The selling company stated that the purchase price for the shares had been determined on the basis of the company´s net present value, calculated according to a calculation of the present value of cash flows. The calculation was made by an outside expert.
- The Supreme Administrative Court noted that although the cash flow calculations in principle can be considered to be an acceptable way to determine the market price of shares in companies not listed on the stock exchange, the estimates presented by the company could not be considered a reliable account of the price that would have been used in a transfer between independent parties.

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TP Methods: India vs. Quark Systems, October 31, 2014

- Quark Systems is engaged in providing customer support services on behalf of the Quark Group.
- TNMM had been applied as the most appropriate method for determining arm´s length income.
- In an audit, the tax administration rejected one of the companies selected as a comparable on the basis that it was a start-up and had losses for consecutive years.
- Quark Systems argued that once functional comparability is established, the comparable should not be rejected on grounds such as start-up phase.
- Quark also argued for rejection of a high-margin comparable on the basis that the company had significant controlled transactions.
- The Appellate Tribunal upheld the need for a proper functional analysis of the tested party and the comparables in determination of ALP and objected to the selection of comparables merely on the basis of business classification provided in the database.
- The case was returned to the tax administration.

TP Methods: Norway vs. Total E&P Norge, March 27, 2015 (Part 1)

- Total E&P Norge AS (Total) is engaged in petroleum exploration and production activities on the Norwegian Continental Shelf. Income from such activities is subject to a special petroleum tax, in addition to the normal corporate tax, resulting in a total nominal tax rate of 78%. In 2002-2007, Total sold gas to the controlled trading companies, and the trading companies resold the gas to third parties on the open market.
- The Supreme Court concluded that Total did not have a right to full access to the comparables. Although section 3-13 (4) of the Tax Assessment Act states that information subject to confidentiality may be given to third parties with the effect that such third parties are subject to the same duty of confidentiality, this rule could not, according to the Supreme Court, be applied in the present case. This was because the very point of the confidentiality obligation in this case was to avoid business secrets' being shared with competitors such as Total.
- *"If the pricing of internal sales shall be deviated, the tax authorities shall still be bound by the general rules in the General Tax Act and the Tax Assessment Act, including the guidelines from the OECD on transfer pricing, which do not prohibit the use of information unknown to the taxpayer, but do call for caution as to how the information is used, so that the taxpayer is given a reasonable opportunity to defend itself, and judicial oversight is ensured."*

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TP Methods: Norway vs. Total E&P Norge, March 27, 2015 (Part 2)

- Further, the Supreme Court found justification for its understanding in a Norwegian article of B. Thu-Gundersen in, Skatteprosess (Ole Gjems-Onstad and Hugo Matre eds., Gyldendal 2010), at 93, on the use of secret comparables, which states as follows:
- *"The comment regarding secret comparables [in the 2010 OECD Guidelines] has, in other words, received a more central placement, and is applicable to all transfer pricing methods. Based on the discussion in the White Paper one can, as before, read the statement as a lowest common denominator of very different points of view. The comment does not appear to state that secret comparables are not allowed, but serves as a warning and call for caution so that the interests of each taxpayer are protected in a reasonable manner."*
- The Supreme Court unanimously upheld the tax assessment and ruled in favor of the tax authorities.

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TP Methods: Italy vs. ILPEA spa, July 25, 2015

- This case is about an Italian company that carries out transactions with its US subsidiary.
- The company stated that there were substantial differences between the products sold to its subsidiary in the United States and the benchmark transactions considered by the Italian tax administration: quality of the products, volumes of sales, terms of sale.
- These differences affected the pricing, so that these transactions could not be compared with other transactions with independent parties.
- The Court found that the transactions carried out with controlled companies must be evaluated according to the “normal value”, defined as the average price charged for similar goods or services with independent parties and at the same marketing stage.
- Therefore, “normal value” is considered to be the ordinary prices of goods and services charged at arm´s length conditions, referring as much as possible, to “pricelists” and “rates”.
- The Court also stated that the tax administration does not have to prove existence of tax evasion, but only the existence of transactions between affiliated companies.
- The taxpayer must prove that the transactions have been priced at market values deemed to be “normal”.

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TP Methods: United States vs. Coca-Cola, December 14, 2015

- The Coca-Cola Company submitted a petition to the U.S. Tax Court, requesting a redetermination of the deficiencies in Federal Income Tax for 3 fiscal years (2007-2009).
- The total amount in dispute was over $3.3 billion for the 3-year period.
- Major issues in the dispute included the method used to allocate profit to seven foreign subsidiaries, which used licensed trademarks and formulas to carry out the manufacture and sale of beverage concentrates in markets outside of the United States, as well as the application of correlative adjustments for foreign tax credits.
- The Coca-Cola Company claimed that it used the same allocation method that had been reviewed and approved by the Internal Revenue Service during audits of tax years from 1996 through 2006, the same that was established in a Closing Agreement with respect to the 1987 through 1995 tax years, entered into in 1996, following a transfer pricing audit of tax years 1987 through 1989.

TP Methods: Canada vs. Marzen Artistic Aluminum, January 29, 2016

- The intercompany transactions at issue involved fees paid to the company´s wholly-owned Barbados based subsidiary during taxation years 2000 and 2001 for sales, marketing and support services.
- The Tax Court of Canada had determined that it was appropriate to apply the CUP method rather than the TNMM, which was advocated by the company´s expert.
- Canada´s Federal Court of Appeal upheld the decision by the Tax Court of Canada, which in 2014 rule that the Canada Revenue Agency had largely been correct in reassessing the taxable income of Marzen Artistic Aluminum Ltd.

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TP Methods: France vs. Sociétè Amycel France, March 16, 2016

- In the case of Sociétè Amycel France, the Court held that the tax administration must use an "appropriate" comparable when making transfer pricing adjustments.
- The French company was selling goods to both group companies and unrelated final customers
- The tax administration had used a transaction with the third party customers as an internal comparable.
- However, as the related companies were acting as distributors, the comparison with the pricing applied to third party customers was considered inappropriate for the purposes of assessing an arm´s length dealing.
- The Court found that the pricing differences actually reflected the fact that the contractual relationship in the two situations was not comparable.

TP Methods: India vs. L´Oreal India, May 4, 2016 (Part 1)

- L´Oreal in India is engaged in manufacturing and distribution of cosmetics and beauty products.
- In respect of the distribution L´Oreal had applied the Resale Price Method (RPM) by benchmarking the gross margin of 40.80% against that of comparables at 14.85%.
- The tax administration rejected the RPM method on the basis that the L'Oreal India was consistently incurring losses and the gross margins cannot be relied upon because of product differences in comparables.
- Accordingly, the tax administration applied Transactional Net Margin Method.
- L'Oreal argued that the years of losses was due to a market penetration strategy in India – not non-arm's-length pricing of transactions.
- The comparables had been on the Indian market much longer than L'Oreal and had established themselves firmly in the Indian market.

TP Methods: India vs. L´Oreal India, May 4, 2016 (Part 2)

- The Appellate Tribunal observed that L'Oreal India buys products from its parent and sells to unrelated parties without any further processing.
- According to the OECD TPG, in such a situation, RPM is the most appropriate transfer pricing method.
- L'Oreal India had also produced evidence from its parent that margin earned by the parent on supplies to L'Oreal India was 2% to 4% or even less. The tax administration had not disputed these facts.
- The tax administrations statement, that the parent have earned higher profit, was not based on facts.
- The Tribunal found that profit earned by the parent was reasonable and hence there was no shifting of profits by L'Oreal India to its parent.

TP Methods: India vs. Gap International, May 17, 2016 (Part 1)

- Gap International Sourcing was engaged in sourcing products from India to other group companies. The activity comprised of assistance in identification of vendors, provision of assistance to vendors in procurement of apparel, inspection and quality control and coordination with vendors to ensure delivery of goods to group companies. The necessary technical and intellectual basis for provision of these services were provided by the group companies.
- The Indian company used TNMM to benchmark the service fee at full cost plus 15%.
- The tax administration disregarded the functional profile and characterization of Gap International Sourcing by assuming that the functional profile was substantially higher than those of limited risk support service providers.
- The tax administration found that a cost plus form of remuneration did not take into account substantial intangible assets owned by the taxpayer. Intangibles were identified to be human asset intangibles, supply chain intangibles and location savings.
- Based on above, the tax administration set the arm's length remuneration at a commission of 5% on the value of the products sourced.

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TP Methods: India vs. Gap International, May 17, 2016 (Part 2)

- The Tribunal held, that for determining the arm’s length price of international transaction, it is important to take the characterization of the taxpayer and the related party into consideration through a functional analysis.
- The Tribunal observed the following specifically for Gap International Sourcing:
  1. No significant business risks were assumed.
  2. No capacity to assume business risks.
  3. No human resource intangibles were developed.
  4. No supply chain intangibles were developed.
  5. Location savings could not be attributed to the taxpayer.
- The Tribunal held that the arm’s-length cost plus mark-up for the taxpayer should be 32% (as opposed to the cost plus 830% and 660% for the two years under consideration, derived by resorting to a commission based on the model of 5%).
- The Tribunal also stated that the arm’s length principle as determined by either the taxpayer or Revenue cannot lead to manifestly absurd or abnormal financial results.

TP Methods: Czech Republic vs. Toll Manufacturer, Sept. 27, 2016

- A Czech toll manufacturer realized losses due to low capacity utilization. Transfer pricing for the manufacturing services had been determined by applying a cost plus method based on a budget costs without a year-end true-up. In 2008, capacity utilization was low due to market conditions and the company incurred a loss.
- The tax authority performed a benchmarking study using the transactional net margin method to determine the arm's length range of net cost plus mark-ups, and issued an adjustment on that basis.
- The Czech manufacturing company argued that the loss was a result of market conditions and appealed the assessment.
- The Supreme Administrative court held that capacity utilization risk should be absorbed by the principal and not the low risk toll manufacturer.
- A low risk toll manufacturer may only end up in a loss position if extra costs result from its own risks – manufacturing inefficiencies. Hence, the appeal was dismissed.

TP Methods: Spain vs. Zeraim Ibérica S.A., October 19, 2016

- In this case, Zeraim Ibérica S.A. argued that the OECD Transfer Pricing Guidelines had not been applied properly, as secret comparables had been used in determining the arm's length price of controlled transactions between the Spanish company and its Dutch parent company.
- The court concluded that the *"..Guidelines are considered to be merely recommendations to States, which are given an interpretative value."*
- The appeal filed by the company was dismissed by the Court.

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TP Methods: Spain vs. Schweppes (Citresa), February 21, 2017

- The Spanish Tax administration made an income adjustment of Citresa (a Spanish subsidiary of the Schweppes Group) Corporate Income Tax for FY 2003, 2004, 2005 and 2006, resulting in a tax liability of €38.6 millions.
- The issue under dispute was the use of TNMM introduced in Spain in 2006. The taxpayer had used the CUP method to verify the arm's length nature of the transaction while the Spanish Tax administration found it more appropriate to use the TNMM.
- Prior to 1 December 2006, the Spanish Corporate Income Tax Act (CIT) did not include the TNMM.
- However, as the Tax Treaty between Spain and the Netherlands was applicable, the Spanish Tax Authorities considered that the OECD Transfer Pricing Guidelines could be directly applicable. Consequently, as the "Transactional Net Margin Method" was envisaged in the Guidelines, the Spanish Tax Authorities understood that this method could be used as a valid valuation method.
- The Court concluded that the CIT Act referred to those legal provisions that had been integrated in the internal Spanish system without the OECD Transfer Pricing Guidelines having legal nature.
- Therefore, the "Transactional Net Margin Method" could not be applied in the financial years 2003, 2004, 2005 and 2006 (January and February).

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TP Methods: Venezuela vs. Brightstar, February 23, 2017

- The Venezuelan tax authority claimed that Brightstar‘s profitability was not arm’s length, based on the profitability of comparable companies, applying the Transactional Net Margin Method.
- The tax court ruled that Brightstar de Venezuela had correctly applied the TNMM and the tax auditors made a mistake when they calculated Brightstar’s profitability.
- The tax authorities should have analyzed each individual transaction and taken into account the segmented financial information of the audited transaction.
- The tax court annulled the adjustment due to non-compliance with the 2010 OECD TP Guidelines.

TP Methods: Sweden vs. Absolut Company, January 16, 2018

- In 2016 the Swedish Tax Tribunal ruled against the tax administration in the case of The Absolut (vodka) Company AB.
- The Administrative Court of Appeal has now overturned the Tribunal's ruling and consequently SEK 247 millions. are now added to the taxable income of The Absolut Company AB.
- The Swedish tax administration found that The Absolut Company AB sold Absolut Vodka below the arm's length price to a group company – The Absolut Spirit Company Inc. (ASCI).
- Furthermore, the Swedish company acquired distribution services from ASCI at a price above the arm's length price.
- The Court addressed:
  1. Timing of data and information in a benchmarking search.
  2. Use of interquartile range or full range.
  3. Use of multiple years data.
  4. The issue of hindsight.

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INTRAGROUP SERVICES

SERVICES: INDIA VS. GEMPLUS INDIA PVT. LTD., MARCH 30, 2009

- Gemplus India Pvt. Ltd. is a part of the Gemplus group, engaged in providing smart card solutions for the telecommunications industry, financial services industry and other e-businesses.
- The company entered into a intra group management services agreement for receipt of services in marketing and sales support, customer service support, finance, accounting and administration support and legal support.
- The tax administration found there was no clear proof that such services had actually been rendered. There was no specific benefit derived by the Indian company. Gemplus India Pvt. Ltd. had not established the benefit of these services and had already incurred expenses towards professional and consultancy services and employed qualified personnel in India for rendering similar services.
- The Appellate Tribunal decided the case in favor of the tax Administration. To satisfy the arm's-length standard, a charge for intra group services or intangibles must at least meet the following conditions:
  1. The need for intra group services or intangibles is established.
  2. The intra group services or intangibles have actually been received.
  3. The benefit from intra group services or intangibles is commensurate with the charge.

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SERVICES: CZECH REPUBLIC VS. CORPORATION, FEBRUARY 27, 2011

- A Czech company (the lessor) owned real estate and rented it to independent parties. An Austrian related company provided management and consulting services to the lessor. The service fees significantly increased each year, although the income of the Czech company and the number of lease contracts were constant in the examined years
- The tax authorities required that the taxpayer prove the actual provision of the services and their relationship to taxable income. The tax authorities rejected this explanation and concluded that the taxpayer had not proven the real condition of the real estate in the examined period.
- The legal question was: the scope of the burden of proof that rests with the taxpayer with respect to services received from related party.
- The Court ruled that: the taxpayer was obliged to prove the relationship of the expensed service fees to its taxable income. Tangible evidence of the provided services, including reports, correspondence and confirmation of business trips should be provided by the taxpayer in order to prove the actual provision of the services.
- This case confirms the strong position of tax authorities when challenging the transfer prices of services. If the taxpayer does not meet the benefit test (proving that the services were actually rendered and incurred in relation to its taxable income), the entire service expense is non-deductible.

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Services: France vs. Sociétè Office Dépôt, January 5, 2012

- In the case of Sociétè Office Dépôt France, a US company recharged a portion of audit costs to the French company.
- The Court found that such costs were incurred in the interest of the US company only, and were accordingly not tax deductible in France.

Services: Italy vs. Alfa Gomma Sud, July 18, 2014

- This case was about tax deductibility of service costs charged to an Italian company by an European Cost Centre within the group.
- The Supreme Court stated that it is necessary to give evidence that the Italian company has actually received a service and that this service is objectively definable and documented.
- The Court ruled in favor of the Italian tax administration.

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SERVICES: FRANCE VS. SOCIÉTÈ PROPERTY INVESTMENT, DECEMBER 9, 2015

- In the case of Sociétè Property Investment Holding, a French company deducted fees paid for management services provided by a foreign related company.
- The court indicated that, even if the recharge concerned fees charged by subcontractors of the foreign company, the French company could only deduct the fees if it could prove that:

  1. The services provided were real.
  2. The services were not duplicates.
  3. The price of the services complied with the arm's length principle.

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SERVICES: NEW ZEALAND VS. HONK LAND TRUSTEE LTD., MARCH 10, 2017

- The Court of Appeal upheld decisions of the High Court confirming the Commissioner of Inland Revenue's disallowance of a $1,116,000 management fee for income tax purposes.
- The Court of Appeal dismissed Honk Land Trustees Limited's appeal on the following alternative grounds:
    1. There was no satisfactory evidence to show that management services were in fact provided.
    2. There was no sufficient nexus shown.
    3. In the event the management fees were deductible, they were nevertheless part of a void tax avoidance arrangement.
- Additionally, the Court of Appeal agreed that the Commissioner was entitled to impose abusive tax position shortfall penalties.

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SERVICES: FINLAND VS. CORPORATION, SEPTEMBER 13, 2017

- This is a Ruling by the Finnish Supreme Administrative Court on a service provider's obligation to add a mark-up on its costs when calculating an arm's length service charge.
- A Finnish corporation had provided services to its subsidiaries related to supply chains, marketing and product brand management services, and human resource management services and other services. Most of the Finnish company´s income consisted of these service. The amount invoiced corresponded to the services´ "production cost". No mark-up had been added.
- The tax administration had set a 7% mark-up determined on the basis on a search of comparative companies.
- The Supreme Administrative Court considered that, in order for the Finnish company´s service charges to be in accordance with the arm's length principle, a profit margin should be added.
- However, the mark-up on the service charges should not have been determined on the basis of the level of profits in third-party comparables.
- The Court found that the profit should be determined on the basis of the benefits from the services to related companies that received the services.
- The tax assessment of 7% were lowered to a 3% mark-up.

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FINANCING TRANSACTIONS

FINANCING: NETHERLANDS VS. CORPORATION, MARCH 1, 2013

- A Dutch company participated in a third party credit arrangement with other group companies.
- The Dutch company was jointly and severally liable for all the receivables that the creditor had on the other group companies under the credit arrangement, and the recourse (of the Dutch company against the other group companies) that arose from such joint and several liability could not be claimed until the full amount outstanding under the credit arrangement had been repaid.
- The Supreme Court found that it could be assumed that a third party would not be willing to provide a guarantee only if, at the moment of granting the guarantee, no guarantee fee could be determined.
- The Supreme Court found that the cross guarantee was an arrangement that originated from shareholder interests.
- Hence a credit loss resulting from a cross-guarantee agreement was not deductible for tax purposes.

Financing: Denmark vs. Bombardier, October 7, 2013

- The issue in the case was whether the applicable rates under the cash pool arrangement were on arm's length, i.e. in accordance with the transfer pricing requirements.
- The Administrative Tax Court concluded that the rate on the short-term deposits and the corresponding loans (borrowed due to insufficient liquidity management) should be the same.
- The Administrative Tax Court observed that However, the rate spread on the net balance of the deposits was lowered from +1.18% to + 1.15%, equal to the borrowing rate spread. The Administrative Tax Court reasoned that the tax authorities had accepted the 1.15% rate spread as the market rate on loans made by the Danish subsidiary and that there were no facts indicating that the deposit rate should be different.
- The Administrative Tax Court also remarked that the adjustment made by the tax authorities was not a recharacterization, but rather a price adjustment.

Financing: Finland vs. Corporation, July 4, 2014

- A Finnish corporation had received from its majority Luxembourgish shareholder a 15 million euros inter-company loan. Finnish corporation had deducted 1,337,500 euros in loan interest.
- The Finnish tax authorities argued that the legal form of the inter-company loan agreed between related parties should be disregarded and loan reclassified as equity. Interest on the loan would therefore not be deductible for the Finnish corporation.
- According to the Supreme Administrative Court, interest on the loan was tax deductible and a reclassification of the loan into equity was not possible under domestic transfer pricing provision
- The Court further noted that it had not been proven or even alleged by the tax authorities that the case was to be regarded as tax avoidance.
- The fact that OECD Transfer Pricing Guidelines could in theory have allowed a reclassification of the legal form of the loan into equity was not relevant because a tax treaty cannot broaden the tax base from that determined under the domestic tax provisions.
- Consequently, the arm´s length principle in Article 9 of the Finnish-Luxemburgish tax treaty only considers the arm´s length principle of the instrument, not the classification of the instrument.

Financing: Switzerland vs. Swisscargo AG, October 16, 2014

- This case is about intercompany loans created by zero balancing cash pooling and the funding of group companies by a group finance company.
- Zero balancing/physical cash pooling involves a physical transfer of money from the accounts of individual group companies to the accounts of the group's cash pooling company and risks can be considerable.
- Group companies participating in the cash pool may lose their funds.
- Loans in the form of cash pool arrangements must be agreed at arm's length terms.
- The Swiss Federal Supreme Court states: *"If the terms of inter-company loans are not conforming to market conditions, then the payment qualifies as a distribution and a special reserve must be made in the balance sheet of the lender".*
- The Court also states: *"It is questionable from the outset whether a participation in the cash pool, by which the participant disposes of its liquidity, can pass the market conditions test at all".*

WORLD BANK GROUP

FINANCING: SWITZERLAND VS. DANISH BANK, MAY 5, 2015

- The Federal Supreme Court denied the refund of withholding taxes claimed by a Danish bank on the basis of the double tax treaty between Denmark and Switzerland due to the lack of beneficial ownership.
- The Danish bank entered into total return swap agreements with different clients. For hedging purposes, the Danish bank purchased a certain amount of the underlying assets (companies listed in the Swiss stock exchange) and received dividend distributions from these Swiss companies.
- The Federal Supreme Court was of the opinion that the Danish bank lost the right for refund of the withholding taxes on the dividends received based on the DTT-DK/CH. According to the Federal Supreme Court, the Danish Bank could not be qualified as the beneficial owner of these shares.
- The Federal Supreme Court denied the beneficial ownership on the grounds that the Danish bank was, in fact, obliged to transfer the dividends to the respective parties of the total return swap agreements.

FINANCING: GERMANY VS. CORPORATION, JUNE 24, 2015

- The Supreme Tax Court has held that a write-off of an irrecoverable related-party loan is not subject to income adjustment under the arm's length rules, although the interest rate should reflect the bad debt risk.
- The German subsidiary of a Canadian group lent money to its under-capitalized UK subsidiary. The debt proved irrecoverable and was written off when the UK company ceased trading.
- At the time, such write-offs were permitted subject to adherence to the principle of dealing at arm's length. The tax office objected that unsecured loans were not at arm's length.
- The Supreme Tax Court has now held that the lack of security does not invalidate the write-off. The lender was entitled to rely on the solidarity of the group.
- However, the interest rate charged should reflect the credit risk actually borne.
- In the meantime, there have been several changes to the relevant statutes. In particular, related-party loan losses can only be deducted if a third party creditor would have granted the finance (or allowed it to remain outstanding) under otherwise similar conditions.

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FINANCING: GERMANY VS. CORPORATION, OCTOBER 14, 2015

- The Supreme Tax Court has requested the Constitutional Court to rule on the conformity of the interest limitation with the constitutional requirement to tax like circumstances alike.
- The interest limitation disallows net interest expense in excess of 30% of EBITDA. However, the rule does not apply to companies with a total net annual interest cost of no more than €3 m or to those that are not part of a group. There are also a number of other exemptions, but the overall effect is to render the actual impact somewhat arbitrary.
- In particular, the asserted purpose of the rule – prevention of profit shifts abroad through deliberate under-capitalization of the German operation – seemed somewhat illusory to the Supreme Tax Court in the light of the relatively high threshold and of the indiscriminate application to cases without foreign connotations.
- The court also pointed out that interest, as such, is a legitimate business expense and that the limitation rule can penalize financing arrangements generally seen as reasonable. Start-ups and crisis management were quoted as examples.
- Overall, the Court found that the interest limitation rule does not meet the constitutional requirements of equal treatment and consistency of application. It has laid the question before the Constitutional Court for a ruling, together with a detailed explanation of its objections. These are a mixture of doubts on the legitimacy of some of the stated aims of the rule and on its suitability as an instrument in meeting others that are legitimate.

Financing: Australia vs. Chevron Australia Ltd., October 23, 2015

- The Australian Chevron case was about a $US 2.5 billion intercompany loan between Chevron Australia and its US subsidiary, Chevron Texaco, and whether the interest paid on the loan by Chevron Australia exceeded the arm's length price.
- Chevron Australia had set up a company in the US, Chevron Texaco Funding Corporation, which borrowed money in US dollars at an interest rate of 1.2% and then made an Australian dollar loan at 8.9% to the Australian parent company.
- This 8,9% interest increased Chevron Australia's costs, and reduced taxable profits.
- These interest payments, which were not taxed in the US, came back to Australia in the form of tax free dividends.
- The US company was just a shell created for the sole purpose of raising funds in the commercial paper market and then lending those funds to the Australian company.

WORLD BANK GROUP

FINANCING: AUSTRALIA VS. CHEVRON AUSTRALIA LTD. (PART 2)

- The Court ruled in favor of the tax administration and the case has since been appealed by Chevron.
- The ruling was based on the following arguments:
  1. The interest rate applied to the intra-group financial transaction was high because there was no security and no financial or operational covenants.
  2. Under similar conditions, an independent entity would have been required to provide security and subject to financial or operational covenants
  3. Hence, at arm’s length the applicable interest rate would have been (much) lower.

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Financing: Germany vs. Corporation, October 21, 2014 (Part 1)

- The German Supreme Tax Court rejected the tax administrations recharacterization of a repayment of share capital to a payment of dividend.
- A German company resolved a share capital reduction of €16 m in preparation for a capital repayment to avoid an IFRS consolidation requirement for its sole shareholder, a public utility.
- It took the reduction to capital reserve, waited as required by the German Company Act for one year after a public announcement to its creditors, reported the reduction to the German trade registry and repaid an amount of €4 m to the shareholder.
- This repayment was sufficient to reduce the assets below the level for the consolidation requirement.
- The tax administration recharacterized the payment to a “dividend distribution” subject to withholding tax under the German Corporate Tax Act provision to the effect that payments to shareholders are deemed to be made from retained earnings unless unambiguously specified as repayments of share capital.

Financing: Germany vs. Corporation, October 21, 2014 (Part 2)

- The Supreme Tax Court concluded that the unambiguous specification need not be solely in the capital reduction/repayment resolution itself.
- The reduction resolution stated being preparatory to a capital repayment to the shareholder, but did not state the (at the time unknown) amount.
- It was clear from all the circumstances that the repayment followed the capital reduction as soon as the German Company Act permitted.
- There was every indication that a capital payment was intended and nothing to suggest that anything else had ever been contemplated.
- Accordingly, the court accepted the payment as a tax-free repayment of share capital, despite the interim booking as a capital reserve.

Financing: Germany vs. Corporation, November 11, 2015 (Part 1)

- The German Supreme Tax Court held – contrary to the finance ministry interest limitation decree – that the exception for interest payments to a significant shareholder of not more 10% of the company's total borrowing cost applies separately for each shareholder, rather than to all significant shareholders cumulatively.
- There are a number of exceptions to the interest limitation rule essentially limiting the annual interest deduction to 30% of EBITDA as shown in the accounts.
- One of these is the equity ratio rule exempting a subsidiary company from the interest limitation provided its equity ratio (ratio of shareholder's equity to the balance sheet total) is no more than two percentage points lower than that of the group and no more than 10% of its net interest cost was paid to any one significant shareholder (a shareholder owning more than 25% of the share capital).
- A loss-making company paying slightly less than 10% of its total net interest cost to each of two significant shareholders claimed exemption from the interest limitation as its equity ratio was better than that of the group.

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FINANCING: GERMANY VS. CORPORATION, NOVEMBER 11, 2015 (PART 2)

- The tax office applied the limitation as the two significant shareholders together received more than 10% of the net interest cost.
- The finance ministry decree on the application of the interest limitation supports this view.
- The Supreme Tax Court has now decided the case in favor of the taxpayer.
- The interest limitation is an exception to the general principle of taxing the net profit of a company and, as an exception, it must be clearly formulated.
- Given this demand for clarity, suggestions that applying the 10% limit to all significant shareholders collectively might better reflect the legislative intention have no relevance in the face of the clear wording of the statute – “one shareholder”.
- Similarly, the same wording also excludes suggestions that each significant shareholder is a related party to all others, since the wording clearly treats each shareholder separately.

FINANCING: AUSTRALIA VS. ORICA LTD., DECEMBER 3, 2015 (PART 1)

- The Orica case involved funding of an overseas entity or operations by an Australian entity, where the funds were subsequently provided back to the Australian entity or its Australian associate in a manner which purportedly generated Australian tax deductions while not generating corresponding Australian assessable income (Free dip).
- The arrangements essentially involved the “round robin” movement of funds where an entity claims income tax deductions in Australia for costs of borrowing or obtaining other financial benefits (including satisfaction of liabilities) from an overseas party.
- The loan or other financial benefit provided by the overseas party is in substance funded, directly or indirectly, by an investment by the entity claiming the deductions or its Australian associate.
- The return on the Australian investment, reflecting the financing costs payable to the overseas party, comes back to Australia in a non-taxable or concessionally taxed form, for example, as a distribution from an overseas subsidiary which is not assessable under Subdivision 768-A of the Income Tax Assessment Act 1997 (ITAA 1997).

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Financing: Australia vs. Orica Ltd., December 3, 2015 (Part 2)

- Similar arrangements may display some or all of the following features:
  - ✓ The entity claiming the Australian tax deductions is related to the overseas party providing the loan or other financial benefit.
  - ✓ The overseas party is an entity resident in a low tax jurisdiction, or is otherwise not taxable in the overseas country on any financing costs payable by the entity claiming the deductions, for example, because it can claim foreign tax credits or tax losses in the overseas country
  - ✓ Use of hybrid entities or instruments such that: i. the financing costs payable to the overseas party which are deducted in Australia are not taxable in the relevant overseas jurisdiction, or ii. the financing costs are deducted twice, i.e. once in Australia and once by the hybrid entity or the hybrid entity's owners in the overseas jurisdiction
  - ✓ The financing costs payable to the overseas party is not income taxable in Australia under Australia's controlled foreign company (CFC) provisions.

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Financing: Australia vs. Orica Ltd., December 3, 2015 (Part 3)

- Similar arrangements may display some or all of the following features:
  - ✓ The non-assessable foreign sourced income distributed to the Australian entity increases its ‘conduit foreign income’ balance so it can distribute unfranked dividends funded from its Australian profits to its foreign shareholders free of dividend withholding tax
  - ✓ There is no cash transfer of relevant funds and relevant steps are said to be carried out by journal entries.
  - ✓ The arrangement produces a commercial outcome or achieves an overall advantage to the global group because of the Australian tax benefits.

FINANCING: SWITZERLAND VS. CORPORATION, DECEMBER 16, 2015

- A Swiss company granted loans to group companies as part of a cash pooling system via the parent company.
- The Swiss tax administration found the interest insufficient, resulting in a hidden profit distribution.
- According to the Swiss rules and doctrine, transactions between related parties must be consistent with the arm's length principle.
- For the third-party comparison, the Court relied on the long-term interest rates, even if the cash pool balances were correctly accounted for as short-term loans.
- The basis for the third-party comparison for the cash pool interest rate was determined to be the market interest rate measured on the 5-year SWAP rate.
- The Court decision was partial approval of the Swiss company and refusal to the Tax administration.

Financing: Italy vs. PDM D s.r.l., April 1, 2016

- This case is about intragroup financing between an Italian company and a related group company in Luxembourg.
- The Supreme Court stated that Italian transfer pricing rules have the purpose of allowing the tax administration to control prices applied to commercial and/or financial transactions between controlled companies resident in different countries in order to avoid any "artificial" adjustments of these prices by the MNE for the purpose of optimizing the group's tax burden, for example by channeling income to companies located in low tax jurisdictions (Luxembourg).

Financing: Italy vs. Edison s.p.a., April 15, 2016

- This case is about inter-group funding.
- The Italian company had qualified a funding arrangement as a non-interest-bearing contribution for future capital increase, hence part of Net Equity.
- The Italian Supreme Court found that intra-group financing agreements are subject to transfer pricing legislation and that non-interest-bearing financing is generally not consistent with the arm's-length principle.

Financing: Spain vs. Peugeot Citroën Automóviles, May 31, 2016

- The company had deducted impairment losses recognized on an investment in an Argentinean company (recently acquired from a related entity) arising from the conversion into capital of loans granted to the entity by other group companies, which had been acquired by the Spanish taxpayer.
- The tax administration argued that acquisition of such loans would not have taken place between independent parties due to the economic situation in Argentina at that time.
- The Supreme Court considered this conclusion to be wrong for two reasons:
    1. From a technical point of view, it was unacceptable to consider that the loans had no market value, since economic reality shows that even in situations of apparent insolvency there is an active market to purchase loans that are apparently uncollectible; and
    2. From a legal point of view, it was not possible to disregard transactions actually carried out between related parties which could be attributed a market value by simply referring to the direct application of Article 9 of tax treaty between Spain and Argentina.
    3. It would have been necessary in this case to apply a general internal anti-abuse clause to carry out this reclassification.

Financing: Sweden vs. Nobel Biocare, June 7, 2016 (Part 1)

- In January 2003, a Swedish company, Nobel Biocare Holding AB, entered into three loan agreements with its Swiss parent company. The loans had 15, 25 and 30 maturity respectively, with terms of amortization and with a variable interest rate corresponding to Stibor plus an interest rate margin of 1.75 percent points for one of the loans and 1.5 percent points for the other two loans. The same day the parent company transferred the loans to a sister company domiciled in the Netherlands Antilles.
- In June 2008 new loan agreements were signed. The new agreements lacked maturity and amortization and interest rates were stated in accordance with the Group's monthly fixed interest rates. Amortization continued to take place in accordance with the provisions of the 2003 agreement, and the only actual change in relation to those agreements consisted in raising the interest rates by 2.5 percent points. These loans were transferred to a Swiss sister company.
- The Swedish Tax administration denied tax deductions corresponding to the difference between the interest rates in 2003 and 2008 respectively, with the support of the Swedish so-called correction rule (arm's length rule).

WORLD BANK GROUP

Financing: Sweden vs. Nobel Biocare, June 7, 2016 (Part 2)

- The question before the Court was whether the correction rule could be applied when a contract with a certain condition was replaced by an agreement with a worse condition?
- The Court stated that a prerequisite for applying the correction rule is that the company's earnings have been lowered as a result of terms being agreed which differ from what would have been agreed between independent parties. It is thus the effect of the earnings that must be assessed and not how a single income or expense item has been affected.
- According to the Court, it was not only the new interest rate in the 2008 agreement that should be used as the basis for the audit, but all of the terms agreed by the parties. Of particular importance was the fact that the company accepted an increased interest rate without compensation, even though the 2003 agreement did not contain any such obligation for the company.
- The Court considered that an independent party had not acted in that way.
- The Court concluded that the correction rule could be applied when a contract with a certain condition was replaced by an agreement with a worse condition. Such an interpretation of the correction rule was considered compatible with the OECD Guidelines.

FINANCING: POLAND VS. CORPORATION, AUGUST 4, 2016

- A group had established a physical cash-pool where funds from participants was transferred to and from a consolidating account (cash pool).
- The Polish Supreme Administrative Court concluded that every agreement in which the lender is obligated to transfer ownership of a specified amount of funds to the borrower, and the borrower is obligated to return the amount and pay interest, even if obligations of the parties to the agreement are implicit, constitutes a loan agreement.

Financing: United States vs. Exelon Corp., September 19, 2016

- The case is about a sale and lease back arrangement characterized as a loan by the US tax authorities referring to “substance over form”.
- The Court agreed with the tax authorities.
- The Court held that all of the test transactions failed the substance over form inquiry because petitioner did not acquire the benefits and burdens of ownership in the assets involved in the test transactions.
- The Court concluded that the test transactions are more similar to loans because petitioner´s return on its investment was predetermined at the time petitioner entered into test transactions.
- Accordingly, petitioner exchanged power plants for an interest in financial instruments.
- Such an exchange fails to meet the “like kind” requirement outlined in the Code and regulations.
- Thus, petitioner must recognize the gain it received on the sale of the power plants.

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Financing: Norway vs. ConocoPhillips, October 5, 2016 (Part 1)

- The case dealt with the benefits of a multi-currency cash pool arrangement.
- The court held that the decisive question was whether the allocation of the benefits was done at arm's length.
- The court dismissed the argument that the benefits should accrue to the parent company. The other circumstances regarding the actual transaction should be recognized when pricing the transaction.
- In order to achieve an arm's length price, the comparison must take into account all characteristics of the controlled transaction except the parties' association with each other.
- While the case was before the Supreme Court, the Oil Tax Board made a new amendment decision, which also included a tax assessment for 2002.
- This amendment, which was based on the same anti-avoidance considerations, was on its own to the company's advantage.

WORLD BANK GROUP

Financing: Norway vs. ConocoPhillips, October 5, 2016 (Part 2)

- Following the Supreme Court judgment, a new amended decision was made in 2009, which reversed the anti-avoidance decision for all three years.
- The Supreme Court concluded that in 2009 the tax authorities could also change the tax assessment for 2002, even though this tax assessment was not considered by the Supreme Court in 2008.
- The Court stated that if the tax authorities have solved a classification or allocation issue for a transaction in the same way for several income years, and there is a final and enforceable judgment for one of the years, the provision gives the tax authorities the right and obligation to also consider the tax assessments for the other years.
- In the specific case, the amendment for 2002 followed from the Supreme Court's judgment for the two preceding income years, and the tax authorities then had the authority to consider the tax assessment for this year.

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FINANCING: NETHERLANDS VS. CORPORATION, OCTOBER 14, 2016 (PART 1)

- Company A had acquired the business (assets and liabilities) of another company, through an Acquisition B.V.
- Company A provided a loan of EUR 300,000 to Acquisition B.V. in 2008. The Acquisition B.V. failed to perform well and went bankrupt in 2011. Company A claimed a write-down loss on the loan in its corporate income tax return.
- The Tax Administration stated that this was an extreme default risk loan and did not accept the loss.
- According to Dutch case law the main characteristic of an EDR loan is that an arm's length interest rate cannot be found – the shareholder grants the loan under such circumstances that it is clear from the outset that it cannot be repaid and the shareholder does not have business interest, other than in its capacity as shareholder, to grant the loan.
- The Arnhem-Leeuwarden Court of Appeal disagreed with the Tax Administration.

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Financing: Netherlands vs. Corporation, October 14, 2016 (Part 2)

- The Supreme Court stated that "special circumstance" between a creditor and a debtor occurs if a business relationship is involved.
- One that would have been of sufficient weight to the creditor to provide a loan under the same conditions and circumstances and to accept the resulting bad debt risk, even without an intercompany relationship.
- The Supreme Court argued that the Court of Appeal had provided insufficient grounds for there not being a "special circumstance" in this case.
- Another issue in this case was the fact that the debtor of the loan was not a subsidiary of company A. Instead, it was a sister company (80% shareholding).
- On this issue the Supreme Court clearly stated that "parallel" deduction of a write-down loss in respect of an extreme default risk loan is not possible.

Financing: Norway vs. IKEA Handel Ejendom, October 18, 2016

- In 2007, IKEA reorganized its property portfolio in Norway so that the properties were demerged from the Norwegian parent company and placed in new, separate companies.
- The shares in these companies were placed in a newly established property company, and the shares in this company were in turn sold to the original parent company, which then became an indirect owner of the same properties.
- The last acquisition was funded through an inter-company loan.
- Based on the non-statutory anti-avoidance rule in Norwegian Tax Law, the Supreme Court concluded that the parent company could not be allowed to deduct the interest on the inter-company loan, as the main purpose of the reorganization was considered to be to save tax.
- The anti-avoidance rule in section 13-1 of the Tax Act did not apply in this circumstance.

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FINANCING: SWITZERLAND VS. CORPORATION, DECEMBER 7, 2016 (PART 1)

- This case draws on the distinction between cash pool receivables and long-term loans.
- The Swiss corporation is a group company of the global A-group. The A Group also includes company F Ltd, which is responsible for the global treasury and cash pooling of the A Group.
- In 2008, the Swiss company entered into an agreement with F Ltd on the short-term deposit of excess liquidity and short-term borrowing (cash pool). Under the terms of the agreement, if the balance were in the Swiss company's favor, receivables would be credited interest based on the one-month London Interbank Bid Rate (LIBID) less 6,25 basis points, but at least 0.05%.
- The Swiss tax administration argued that a portion of the cash pool receivable had to be treated as a long-term loan bearing higher interest rates. The long-term loan was set to the minimum cash pool receivable balance of each fiscal year.
- The interest rate on the long-term loan was set to the Swiss "Safe Harbor Rates" according to the annual circular letters published by the Swiss Federal Tax Administration.

FINANCING: SWITZERLAND VS. CORPORATION, DECEMBER 7, 2016 (PART 2)

- The Tax Appeal Court largely confirmed the decision of the tax administration.
- However, it reduced the applicable interest rate for the calendar year 2011 from 2.25% to 2.00%.
- The Tax Appeal Court argued that the tax administration had unreasonably deviated from its longstanding method when determining the 2011 safe harbor interest rate, so that the 2.25% mentioned in the circular letter were too high.
- The Swiss company appealed the decision to the Administrative Court.

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FINANCING: SWITZERLAND VS. CORPORATION, DECEMBER 7, 2016 (PART 3)

- Based on the overall circumstances, the amount of the assets invested in the cash pool did not comply with the arm's length principle according to the Administrative Court.
- In this respect, it was correct to qualify a portion of the cash pool receivable into a mid- or long-term loan.
- Concerning the size of the long term loan, the simple average of the cash pool receivable balance at the beginning and closing of the fiscal year could be taken as a starting point according to the Administrative Court. This question was referred back to the tax administration.
- Concerning the applicable interest rate on the long-term loan, the Administrative Court stated, that the tax authorities cannot in every case refer to the Swiss "Safe Harbor Rates".
- The Court concluded that the interest rates offered by F Ltd. for long-term intra-group loans were in line with the arm's length principle.

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Financing: Venezuela vs. Sodexho, December 15, 2016

- Sodexho Venezuela had appealed an adjustment made under the Venezuelan transfer pricing rules.
- The tax authorities claimed that the interest rate charged by Sodexho on a loan, made to a related party outside Venezuela, was not at arm's-length.
- The tax authorities claimed that when applying the CUP method and comparing the controlled transaction with an uncontrolled transaction, Sodexho Pass Venezuela should have used an active rate such as the prime rate.
- The Tax Court ruled that Sodexho had correctly applied the CUP method and therefore cancelled the transfer pricing adjustment.

WORLD BANK GROUP

FINANCING: SPAIN VS. MCDONALD´S, MARCH 2, 2017

- This case is about adjustments made to a series of loans granted by GOLDEN ARCHES OF SPAIN SA (GAOS) to RMSA, throughout the period 2000/2004 for amounts ranging between 10,000,000 and 86,650,000 €, at a interest rate that between 3,450% and 6,020%.
- The Spanish tax administration argues that GAOS “has no structure or means to grant the loan and monitor compliance with its conditions … it does not have its own funds to lend, it receives them from other companies in the group”.
- In fact, the Administration refers to a loan received by GAOS from the parent company at a rate of 0%, which is paid in advance to receive another with an interest rate of 3.3%.
- The Administration indicates that “nobody, under normal market conditions, cancels a loan to constitute another one under clearly worse conditions”.
- The Court concluded that the OECD guidelines were not part of the Spanish legal system and that the innovations introduced by the Spanish Corporate Income Tax Act of 2006 were not applicable to periods previous to 2006.

FINANCING: AUSTRALIA VS. CHEVRON, APRIL 21, 2017

- This case was about a cross border financing arrangement used by Chevron Australia to reduce its taxes – a round robin.
- Chevron Australia had set up a company in the US, Chevron Texaco Funding Corporation, which borrowed money in US dollars at an interest rate of 1.2% and then made an Australian dollar loan at 8.9% to the Australian parent company.
- The loan increased Chevron Australia's costs and reduced taxable profits. The interest payments, which were not taxed in the US, came back to Australia in the form of tax free dividends.
- The US company was just a shell created for the sole purpose of raising funds in the commercial paper market and then lending those funds to the Australian company.
- Australian Courts ruled in favor of the tax administration and the case was since appealed by Chevron.
- In April 2017 the Federal Court decided to dismiss Chevron's appeal.

WORLD BANK GROUP

Financing: Norway vs. Hess Norway, May 30, 2017

- In this case, a Norwegian subsidiary of an international group (Hess Oil), refinanced an intra-group USD loan two years prior to the loans maturity date. The new loan was denominated in Norwegian kroner and had a significantly higher interest rate.
- The tax authorities reduced the interest payments of the Norwegian subsidiary pursuant to section 13-1 of the Tax Act for fiscal years 2009 – 2011, thereby increasing taxable income for years in question with a total of kroner 262 million.
- The Court of Appeal found for the most part in favor of the tax administration.
- Under the circumstances of the case, neither the claimed refinancing risk nor the currency risk could sufficiently support it being commercially rational for the subsidiary to enter into the new loan agreement two years prior to the maturity date of the original USD loan.
- When applying the arm's length principle, the company's refinancing risk had to be based on the Norwegian company's actual situation as a subsidiary in the Hess Oil group.

Financing: Norway vs. Exxonmobil Norway, January 22, 2018 (Part 1)

- An assessment was issued by the Norwegian tax authorities for years 2009 2010 and 2011 concerning the interest on a loan between Exxonmobil Production Norway Inc. (EPNI) as the lender and Exxon Mobile Delaware Holdings Inc. (EMDHI) as the borrower.
- Both EPNI and EMDHI are subsidiaries in the Exxon Group, where the parent company is domiciled in the United States.
- The loan agreement between EPNI and EMDHI was entered into in 2009. The loan had a drawing facility of NOK 20 billion. The agreed maturity was 2019, and the interest rate was fixed at 3 months NIBOR plus a margin of 30 basis points.
- The agreement also contained provisions on quarterly interest rate regulation and a interest adjustment clause allowing the lender to adjust the interest rate on changes in the borrower’s creditworthiness.
- The dispute concerns the margin of 30 basis points and the importance of the adjustment clause, also referred to as the step-up clause.

Financing: Norway vs. ExxonMobil Norway, January 22, 2018 (Part 2)

- The Oil Tax office and the Appeals Board for Oil Tax found that the agreed interest rate was not at arm's length and taxable income for the three relevant years was increased by a total of NOK 95,525,000.
- EPNI filed an appeal to Oslo District Court.
- In 2016 the District Court ruled in favor of the tax authorities.
- EPNI then filed an appeal to the National Court of Appeal.
- The National Court of Appeal concluded that the interest payments had not been at arm's length and dismissed the appeal.
- In the decision, reference is made to the Norwegian Supreme Court decision in the Statoil Angola case from 2007.

Financing: Norway vs. Statoil Angola, June 26, 2007 (by reference)

- Two inter-company loans were provided to Statoil Angola by its Norwegian parent company, Statoil Norway ASA, and a Belgian sister company, Statoil Belgium (SCC).
- Statoil Angola only had the financial capacity to borrow an amount equal to the loan from Statoil Belgium. Hence, no interest was paid on the loan from Statoil Norway.
- The tax authorities divided Statoil Angola's borrowing capacity between the two loans and imputed interest payments on part of the loan from Statoil Norway in an assessment for the years 2000 and 2001.
- The Norwegian Supreme Court, in a split 3/2 decision, found that Statoil's allocation of the full borrowing capacity of Statoil Angola to the loan from the sister company in Belgium was based on commercial reasoning and in accordance with the arm's length principle.
- The Court majority argued that Statoil Norway – unlike Statoil Belgium – had a 100% ownership of Statoil Angola, and the lack of interest income would therefore be compensated by an increased value of its equity holding in Statoil Angola.

FINANCING: INDIA VS. VODAFONE INDIA SERVICES, JANUARY 24, 2018

- The 2018 Vodafone case from India discussed whether termination of option rights under an agreement can be treated as a “deemed international transaction” under domestic tax law.
- Vodafone India Services had a call option to buy shares in SMMS Investment Pvt. Ltd., which held over 5% equity capital of the Vodafone India through a web of holdings.
- Under the same agreement, if Vodafone India Services terminated its right to acquire the shares it would have to pay a significant amount. Instead of exercising the call option and acquiring the valuable shares at a very low price, Vodafone India Services terminated the option and paid.
- The tax administration held that Vodafone India Service should have received a substantial consideration for not exercising the option.
- Vodafone India Services held that termination of an option was not a transaction. It also argued that it was not an international transaction, but a deal between domestic companies.
- The tribunal held in favor of the tax administration. The deal was deemed an international transaction. The consideration value was to be assessed on the price of the shares that were later sold in the market.

INTANGIBLES & ROYALTIES

INTANGIBLES: NETHERLANDS VS. CORPORATION, MAY 4, 2007

- This case was about an IP sale-and-license-back arrangement.
- Initially A BV developed, manufactured and marketed sporting shoes. Then in January 1994 a Sale and license-back arrangement of trademark B was entered with B BV whereby the trademark was transferred to B BV. Trademark B was also the tradename of B BV.
- In July 1994, B BV moved to the Dutch Antilles.
- In 1999 the royalty for use of the trademark was increased from fl. 2 per pair of shoes to fl. 2.50 per pair, resulting in annual royalty payments of fl. 300.000 from A BV to B BV.
- The Court disallowed tax deductions for the royalty payments.
- The payments were not proven to be at arm’s length.
- B BV had no employees to manage the trademarks.
- There were no business reasons for the transactions, only a tax motive.
- Hence the sale-and-license back arrangement was disregarded for tax purposes.

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INTANGIBLES: UNITED STATES VS. VERITAS SOFTWARE, DECEMBER 10, 2009

- Veritas US assigned all of its existing European sales agreements to Veritas Ireland. Similarly, Veritas Ireland was given the rights to use the covered intangibles and to use Veritas US's trademarks, trade names and service marks in Europe, the Middle East and Africa, and in Asia-Pacific and Japan.

- In return, Veritas Ireland agreed to pay royalties to Veritas US in exchange for the rights granted. The royalty payment included a lump-sum payment along with running royalties that were subject to revision to maintain an arm's length rate. Thereafter, Veritas Ireland began co-developing, manufacturing and selling Veritas products in the Europe, the Middle East and Africa markets as well as in the Asia-Pacific and Japan markets. These improvements, along with the establishment of new management, allowed Veritas' 2004 annual revenues to be five times higher than its 1999 revenues.

- The IRS's economic expert employed the income method to calculate the buy-in payment (for pre-existing intangibles that were to be used by the parties to develop future technology under the cost sharing arrangement). These calculations were based on the assumption that the transfer of pre-existing intangibles by Veritas US was "akin to a sale" and should be evaluated as such.

WORLD BANK GROUP

Intangibles: United States vs. Veritas Software (Part 2)

- To value the transfer, the IRS expert aggregated the intangibles so that, in effect, he treated the transfer as a sale of Veritas US's business, rather than a sale of each separate intangible asset. The aggregation of the intangibles was necessary, in the view of the IRS expert, because the assets collectively (the package of intangibles) possessed synergies and, as a result, the package of intangibles was more valuable than each individual intangible asset standing alone.
- The Court rejected the IRS's method on the following premises:

  1. The IRS did not differentiate between the value of subsequently developed intangibles and pre-existing intangibles, thus including intangibles beyond what is required for the buy-in payment;
  2. The IRS included intangibles such as access to Veritas US's marketing and R&D teams, which are not among the intangibles recognized by the US transfer pricing rules; and
  3. The IRS incorrectly assigned a perpetual useful life for transferred intangibles that have a useful life of four years.

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INTANGIBLES: INDIA VS. MARUTI SUZUKI INDIA LTD., JULY 1, 2010

- Maruti Suzuki India manufactures and sells cars and spare parts. A license agreement had been entered with the group parent for use of licensed information and trademark for the manufacture and sale of the products. Hence, Maruti Suzuki paid royalties to the parent for trademark and technology.
- The tax administration made an adjustment where the royalty paid for use of the trademark was disallowed and where a reimbursement with mark-up for non-routine advertising, marketing and promotion of the brand name was imputed.
- The High Court, referred the case back to the tax administration with observations.
    1. If there is an agreement between the group parent and the taxpayer which carries an obligation on the taxpayer to use the trademark owned by the group parent. Such agreement should be accompanied either by an appropriate payment by the group parent or by a discount provided to the taxpayer.
    2. Appropriate payment should be made on account of benefit derived by the group parent in the form of marketing intangibles obtained from such mandatory use of the trademark.
    3. However, if the agreement between the group parent and Maruti Suzuki for the use of the trademark is discretionary, no payment is required to the foreign entity.

WORLD BANK GROUP

INTANGIBLES: ITALY VS. COMPUTER ASSOCIATES S.P.A., FEBRUARY 27, 2013

- This case is about royalties paid by an Italian company to a US associated company.
- The tax authorities had challenged the inter-company royalty paid (7%) despite the fact that the taxpayer had provided an economic analysis that justified a higher royalty rate.
- The Supreme Court ruled in favor of the tax administration.

WORLD BANK GROUP

Intangibles: Canada vs. Skechers USA, March 2, 2015

- Skechers Canada, a subsidiary of Skechers USA, purchases footwear to sell in Canada from its parent at a price equal to the price paid by Skechers US to its manufacturers, the cost of shipping the foodware to the US and warehousing, and an arm's length profit.
- Skechers Canada also makes payments to Skechers US pursuant to a cost sharing agreement to compensate the parent for activities associated with the development and maintenance of the Skechers brand and to the creation and sale of footwear.
- The Court ruled that cost sharing arrangement (CSA) payments relating to research, design, and development (R&D) were "in respect of" the goods sold for export into Canada and thus part of the "price paid or payable" for the goods for customs purposes.
- As a result, Skechers Canada must add the amounts of these payments made to Skechers USA to the customs value of imported footwear supplied by its parent.

WORLD BANK GROUP

Intangibles: Germany vs. Corporation, January 21, 2016

- The German Supreme Tax Court has held that a parent company cannot be deemed to have earned income from allowing its Polish subsidiary to register locally in the group name.
- A German business was active in a field of patented technology associated with its own firm name, “B”. It allowed its Polish subsidiaries to register in that name, “B Sp.z.o.o.”, but made an appropriate charge for the use of the technology. It also did not authorize the Polish companies to use its logo, but left it up to them to design their own.
- The tax office maintained that the group name was a valuable intangible and demanded an income adjustment to reflect its use by foreign subsidiaries.
- However, the Supreme Tax Court has now confirmed its previous case law in holding that the mere use of the group name in the company registration of a subsidiary – including the right to trade under that name – does not give rise to a royalty entitlement of the parent.
- Such entitlement only arises in connection with other associated rights, such as the use of a logo or technology, in which case, the benefit from the use of intangibles should be seen as a package. However, this did not arise in the case at issue, as the rights to the logo had not been assigned and the rights to the technology had been charged for separately.

WORLD BANK GROUP

INTANGIBLES: UNITED STATES VS. MEDTRONIC, JUNE 9, 2016

- The IRS argued that Medtronic Inc. failed to accurately account for the value of trade secrets and other intangibles owned by Medtronic Inc. and used by Medtronic's Puerto Rico manufacturing subsidiary in 2005 and 2006 when determining the royalty payments from the subsidiary.
- In 2016 the United States Tax Court found in favor of Medtronic, sustaining the use of the CUT method to analyze royalty payments.
- The Court also found that adjustments to the CUT were required. These included additional adjustments not initially applied by Medtronic Inc. for know-how, profit potential and scope of product.
- The decision from the United States Tax Court has been appealed by the IRS in 2017.

Intangibles: Denmark vs. Corporation, March 13, 2017

- In this case, the Danish Tax administration had made an estimated assessment due to a insufficient TP documentation. In the assessment goodwill amortizations were included when comparing the operating income of the company to that of independent parties in a database survey.
- The Tax Tribunal found that the tax administration was not entitled to make an estimated assessment under Danish tax law, where the TP documentation provided a sufficient basis for assessing whether prices and terms were in accordance with the arm’s length principle.
- According to the Tax Tribunal, goodwill amortizations should not be included when comparing the operating income of the company to the operating income of independent parties in a database survey. Hence the assessment was reduced to DKK 0.
- The case has been appealed to the Danish National Court by the tax authorities.

WORLD BANK GROUP

Intangibles: United States vs. Amazon, March 23, 2017 (Part 1)

- In 2005, Amazon US entered into a cost sharing arrangement (CSA) with its Luxembourg subsidiary, Amazon Lux.
- Pursuant to entering the CSA, Amazon US granted Amazon Lux the right to use certain pre-existing intangible assets in Europe, including the intangibles required to operate Amazon's European website business.
- This arrangement required Amazon Lux to make an upfront "buy-in payment" to compensate Amazon US for the value of the intangible assets that were to be transferred to Amazon Lux.
- As consideration for the transfer of pre-existing intangibles, Amazon Lux made a $254.5 million buy-in payment to Amazon US.
- Applying a discounted cash-flow (DCF) methodology to the expected cash flows from the European business, US tax administration determined a buy-in payment of $3.5 billion.

INTANGIBLES: UNITED STATES VS. AMAZON, MARCH 23, 2017 (PART 2)

- US CSA regulations in effect for 2005-2006 define intangibles to include five enumerated categories of assets, each of which has "substantial value independent of the services of any individual." These include patents, inventions, copyrights, know-how, trademarks, trade names, and 20 other specified intangibles.
- The definition of intangibles in the old CSA regulations did not include the value of workforce in place, going concern value, goodwill, and growth options, corporate resources or opportunities.
- In 2011 new CSA regulations were introduced in the US, which use the concept of "platform contribution transaction" (PCT), and does not limit the type of intangibles that must be compensated under a cost sharing arrangement.
- However, these new US CSA regulations did not apply in the Amazon case and the US Tax Court ruled in favor of Amazon.

INTANGIBLES: ISRAEL VS. GTEKO LTD. (MICROSOFT), JUNE 6, 2017

- In November 2006, Microsoft Corp. purchased 100% of the shares of Gteko Ltd. (IT Support technology), for USD 90 million.
- The purchase was made with the intention of integrating Gteko’s technology into Microsoft’s own products.
- Following this purchase of Gteko Ltd., the employees were transferred to the local Microsoft subsidiary and a few months later another agreement was entered transferring Gteko’s intellectual property/intangibles to Microsoft.
- This transfer was priced at USD 26 million based on the purchase price allocation (PPA).
- The tax authorities of Israel found that the price of 26 millions USD used in the transaction was not at arm’s length.
- It was further argued, that the transaction was not only a transfer of some intangibles but rather a transfer of all assets owned by Gteko as a going concern to Microsoft Corp.
- The arm’s length price for the transfer was set at USD 80 million.
- The District Court agreed with the assessment.

INTANGIBLES: FRANCE VS. HAVAS, JULY 12, 2017

- The French Court considers that in the event of a transfer of shares, the goodwill recognized at the acquisition of the shares shall no longer be included in the balance sheet of the parent company.

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INTANGIBLES: UNITED STATES VS. COCA COLA, DECEMBER 14, 2017 (PART 1)

- Coca Cola collects royalties from foreign branches and subsidiaries for use of formulas, brand and other intellectual property.
- Years ago an agreement was entered by Coca Cola and the IRS on these royalty payments to settle an audit of years 1987 to 1995.
- According to the agreement, Coca-Cola licensees in other countries would pay the US parent company royalties using a 10-50-50 formula where 10% of the gross sales revenue is treated as a normal return to the licensee and the rest of the revenue is split evenly between the licensee and the US parent, with the part going to the US parent paid in the form of a royalty.
- The agreement expired in 1995, but Coca-Cola continued to use the model for transfer pricing in the following years.
- Coca-Cola and the Mexican tax authorities had agreed on the same formula and Coca-Cola continued to use the pricing-formula in Mexico on the advice of Mexican counsel.

WORLD BANK GROUP

INTANGIBLES: UNITED STATES VS. COCA COLA, DECEMBER 14, 2017 (PART 2)

- In 2015, the IRS made an adjustment related to 2007–2009 tax returns stating that Coca-Cola licensees should have paid a higher royalty to the US parent.
- On that basis, the IRS said that too much income had been declared in Coca Cola's tax returns in Mexico because a higher royalty should have been deducted.
- The IRS therefore disallowed $43.5 to $50 million in foreign tax credits in each of the three years for taxes that the IRS said Coca-Cola overpaid in Mexico due to failure to deduct the right amount of royalty payments – voluntary tax payments cannot be claimed as a foreign tax credit in the United States.
- The court sided with Coca-Cola on this question and concluded that all practical remedies to reduce Mexican taxes had been exhausted and Coca Cola foreign tax credits were to be allowed.

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BUSINESS RESTRUCTURING

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RESTRUCTURING: NORWAY VS. CYTEC, SEPTEMBER 26, 2007

- This case is about business restructuring and transfer of intangibles – customer portfolio, technology, trademarks and goodwill.
- Cytec Norge (Norway) was originally a full-fledged manufacturer that was changed into a toll manufacturer. The customer portfolio, technology, trademarks and goodwill were transferred to the related entity, Cytec Netherlands, free of charge.
- The court found that Cytec Norge AS had held intangibles of considerable value prior to the business restructuring in 1999, and that the Norwegian entity should have received an arm's-length remuneration for the transfer of these rights to the related Dutch entity.
- The court ruled that the Norwegian tax authorities' calculation of such remuneration and the increased income was correct.
- An appeal to the Supreme Court was dismissed in 2008.

Restructuring: France vs. Zimmer Ltd., March 25, 2010

- The French company, Zimmer SAS, distributed products for Zimmer Limited.
- In 1995 the company was converted into a commissionaire (acting in its own name but on behalf of Zimmer Ltd.).
- The French tax authorities argued that the commissionaire was taxable as a permanent establishment of the principal, because the commissionaire could bind the principal.
- The Court ruled that the commissionaire could not bind the principal. Therefore, the French commissionaire could not be a permanent establishment of the principal.

RESTRUCTURING: SPAIN VS. BOREX, FEBRUARY 9, 2011

- A Spanish subsidiary of a UK Group (Borex), which imported, processed and sold the materials to third parties, was transformed into a a contract manufacturer.
- The Spanish subsidiary signed two separate contracts with the UK parent, one for warehousing and the provision of services and the other in respect of an sales agency.
- Under the first contract, the minerals purchased by the parent would be stored and processed by the subsidiary, which would also provide other relevant services. Under the second contract, the Spanish subsidiary would promote sales of the minerals in Spain, but, as the prices and conditions were fixed by the UK parent, the subsidiary would only send orders to the parent, which was not bound to accept them. The subsidiary could not accept orders in the name of the parent or receive payment.
- The tax administration argued that there was a high degree of overlapping between the activities carried out by the parent and the subsidiary. Warehousing, service and promotion of sales activities could not be considered separately, and, therefore, that there was a PE in Spain, as the activities were not preparatory or auxiliary.
- The Court concluded that, article 5(3) of the Spain-UK Tax Treaty (article 5(4) of the OECD Model) did not apply, as the activities in the subsidiary could not be considered in isolation, but were to be considered part of a chain that completed an economic cycle in Spain.

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Restructuring: Spain vs. Roche, January 12, 2012 (Part 1)

- This case is about the consequences of converting a manufacturer and full-fledged distributor into a toll manufacturer and commissionaire, without actually changing the underlying operations.
- The Supreme Court decided that the restructured Spanish entity acted as a manufacturing agent that created a PE. The profits attributed to the PE included not only the manufacturing profits but also the profits from the distribution activity on behalf of Roche Vitamins Europe Ltd. in Switzerland.
- Prior to a business restructuring in 1999, the Spanish subsidiary was a full-fledged distributor, involved in manufacturing, importing, and selling the pharmaceutical products in the Spanish and Portuguese markets.
- In 1999 the Spanish subsidiary and the Swiss parent entered into two agreements. Under the manufacturing agreement, the Spanish subsidiary manufactured products according to directions and using formulas, know-how, patents, and trademarks from the Swiss parent. These manufacturing activities were remunerated at cost plus 3.3 percent.

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RESTRUCTURING: SPAIN VS. ROCHE, JANUARY 12, 2012 (PART 2)

- Under the distribution (agency) agreement, the Spanish subsidiary would "represent, protect and promote" the products. These activities were remunerated at 2 percent of sales.
- After entering the two agreements the Spanish subsidiary was characterized as a contract manufacturer and commission agent with profits were much lower than before the business restructuring.
- The Spanish tax authorities argued that the Swiss parent created a PE in Spain. Therefore, part of the Swiss profits should be allocated to the Spanish subsidiary.
- The Spanish Supreme Court agreed with the tax authorities.

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RESTRUCTURING: FRANCE VS. SOCIÉTÈ NESTLÉ FINANCE, FEBRUARY 5, 2013

- In the Nestlé Finance case, a cash pool/treasury activity was transferred to a related Swiss entity.
- The function had been purely administrative, carried out exclusively for the benefit of parties related to the French company.
- The French company did not receive any compensation for the transfer of the cash pooling activity.
- First the Administrative Court concluded that the transfer of an internal administrative function to a foreign entity – even if the function only involved other affiliated companies 'captive clientele' – required the payment of arm's-length compensation.
- This decision was then appealed and later revoked by a decision of the Administrative Court of Appeals.

RESTRUCTURING: DENMARK VS. CORPORATION, OCTOBER 8, 2015

- A Danish production company terminated a 10-year license and distribution agreement with a group distribution company one year prior to expiry of the agreement.
- The distribution agreement was transferred to another group company and the new distribution company agreed as a successor in interest to pay a "termination fee" to the former distribution company.
- However, the termination fee was paid by the Danish production company and the amount was depreciated in the tax-return.
- The Danish company claimed that it was a transfer pricing case and argued that the tax administration could only adjust agreed prices and conditions of the agreement if the requirements for making a transfer pricing correction were met.
- The Supreme Court found that payment of the termination fee did not have sufficient connection to the Danish company's income acquisition for the payment to be tax deductible.
- The applicant was therefore not entitled to tax depreciation of the payment.
- The Danish Supreme Court ruled in favor of the Danish tax administration.

RESTRUCTURING: SPAIN VS. DELL, JUNE 20, 2016 (PART 1)

- Dell Spain is part of a multinational group (Dell) that manufactures and sells computers. Dell Ireland, operates as distributor for most of Europe. Dell Ireland has appointed related entities to operate as its commissionaires in several countries; Dell Spain and Dell France are part of this commissionaire network.
- The Dell Group operates through a direct sales model. Purchase orders are placed on a web page or in a call center.
- Dell Spain operated as a full-fledged distributor.
- After the restructuring, Dell Spain serves large customers of the group, through a commissionaire agreement with Dell Ireland. In many cases, large customers require specialized services and Dell Spain's client support personnel serves them. Sales to private customers in Spain are conducted by Dell France, through a call center and a web page.
- The Supreme Court concluded that the activities of Dell Spain constituted a PE of Dell Ireland under both the "dependent agent" and "fixed place of business" clauses of the treaty.
- The Supreme Court considered that Dell Spain could not be deemed as an independent agent since it operated exclusively for Dell Ireland under control and instructions from the same.

RESTRUCTURING: SPAIN VS. DELL, JUNE 20, 2016 (PART 2)

- Regarding the “fixed place of business”, the Supreme Court interprets that having a place at the principal’s disposal also includes the use of such premises through another entity which carries out the principal’s activity under its supervision.
- The Court also explained that considering a company as a PE is not only its capacity to conclude contracts that bind the company but also the functional and factual correlation between the agent and the company in the sense that the agent has sufficient authority to bind the company in its day to day business, following the instructions of the company and under its control.
- Consequently, all of the revenue from Dell’s product sales in Spanish territory were taxable in Spain due to the above functional correlation.
- The Supreme Court decision was in line with prior decisions by the Spanish Supreme Court with regard to post-restructuring schemes and commissionaire dealings involving complex business structures in Spain.

Restructuring: Netherland vs. Corporation, October 27, 2017

- A Dutch parent company was providing support services to its foreign subsidiary on a cost-plus basis and received a compensation fee following a business restructuring where headquarter and strategic functions were transferred from the Dutch parent company to Switzerland.
- The Dutch tax authorities took the view that the compensation paid was insufficient, and that the Dutch parent company was still performing strategic functions for the group.
- The Court ruled that the taxpayer had fulfilled its legal obligations by preparing thorough transfer pricing documentation and that the burden of proof was on the Dutch tax authorities.
- The Court ruled that the tax authorities did not provide sufficient arguments to support the adjustment.
- The original assessment of €188 millions was reduced to a calculated taxable profit of €42.6 millions and a taxable amount of €32 millions.

MAP & APA

MAP: GERMANY VS. US TAXPAYER, OCTOBER 9, 2013

- The Supreme Tax Court has held that the costs incurred by a taxpayer in connection with a tax treaty mutual agreement proceeding are not costs of earning the relevant income, but has left open a possible deduction as “unusual expenses”.
- A US resident realized a gain on the sale of a share in a GmbH. The German tax office sought to tax the gain, but the taxpayer objected on the grounds that it was taxable in the US under the double tax treaty. This tax office did not accept this objection, so a mutual agreement proceeding was requested in an effort to clear the issue. Ultimately, the two governments agreed to split the taxing right in the ratio 60:40 in favor of Germany. However, the taxpayer had incurred various consultancy and legal costs in the course of the process and these should, he claimed, be deducted from the taxable gain, as they would not have arisen without it. The tax office refused this, too.
- The Supreme Tax Court has now held that the costs at issue were not direct costs of making the gain. They were incurred in the course of resolving a dispute over the right to tax it and thus did not arise until after it had been made. Admittedly, without the gain, they would not have been incurred at all, although this connection was too remote to allow classification as direct costs. The court explicitly left the question open as to whether they might have been allowable against total income as “unusual expenses”, as that deduction is only available to German residents.

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MAP: Canada vs. Sifto Canada Corp., March 10, 2017

- The issue before was whether the Canadian revenue service had the ability to issue the second reassessments given the Canadian and US competent authorities subsequently agreed on a MAP settlement.
- The Tax Court found that a settlement agreed to via the competent authority precluded a subsequent tax-reassessment that attempted to further increase the taxpayer’s income.

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APA: United States vs. Eaton Corporation, July 26, 2017

- The IRS decided to cancel two advance pricing agreements (APAs) with Eaton Corporation.
- The US Tax Court ruled that this decision was an abuse of discretion.

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APA: EU Court of Justice vs. Hamamatsu, December 20, 2017 (Part 1)

- The case concerns the effect of transfer pricing year-end adjustments on VAT – the relationship between transfer pricing and the valuation of goods for customs (VAT) purposes.
- Hamamatsu Photonics Deutschland GmbH (Hamamatsu) is a German subsidiary of the Japanese company Hamamatsu, and it acts as a distributor of optical devices purchased from the parent company.
- The transfer pricing policy of the group, which is covered by an Advanced Pricing Agreement (APA) with the German Tax Authorities, provides that the consideration paid by Hamamatsu to purchase the goods sold allows Hamamatsu Photonics a target profit.
- Hamamatsu accounted for an operating margin below the threshold agreed upon in the APA. The Japanese parent company consequently carried out a downward adjustment to allow the achievement of the target profitability by its German subsidiary.

APA: EU Court of Justice vs. Hamamatsu, December 20, 2017 (Part 2)

- Hamamatsu filed a refund claim for the higher customs duties paid on the price that was declared to customs at the time of importation. Customs, at that stage, did not seem to have challenged the carrying of adjustments but refused the refund claim, arguing that no allocation of the adjustment to the individual imported goods was made.
- German Court referred the following questions to the Court of Justice for a preliminary ruling:

(1) Do the provisions of the German Customs Code permit an agreed transfer price, which is composed of an amount initially invoiced and declared and a flat-rate adjustment made after the end of the accounting period, to form the basis for the customs value, using an allocation key, regardless of whether a subsequent debit charge or credit is made to the declarant at the end of the accounting period?

(2) If so, may the customs value be reviewed and/or determined using simplified approaches where the effects of subsequent transfer pricing adjustments (both upward and downward) can be recognized?

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APA: EU Court of Justice vs. Hamamatsu, December 20, 2017 (Part 2)

- The EUCJ ruled that the Customs Code, in the version in force, must be interpreted as meaning that it does not permit an agreed transaction value, composed of an amount initially invoiced and declared and a flat-rate adjustment made after the end of the accounting period, to form the basis for the customs value, without it being possible to know at the end of the accounting period whether that adjustment would be made up or down.

MAIN TAKEAWAYS

TAKEAWAYS: BURDEN OF PROOF (PART 1)

- To be suitable for comparison, companies need to be independent and in the same market. *(France)*
- There is economic control in a situation where the rent for premises used by an entity is paid by another entity. *(France)*
- The proof of transfer of profits abroad requires the relevance of the methods used and of the comparables found by the tax authorities. *(France)*
- When a transaction is “inherently startling”, it is the party making the transaction the one that must justify the reasonableness despite the appearance of it. *(Spain)*
- U.S. Income Tax Regulations let the Commissioner aggregate two or more separate transactions to the extent that aggregation serves as the most reliable means of determining the arm´s length consideration for the transactions. *(United States)*

TAKEAWAYS: BURDEN OF PROOF (PART 2)

- The formation of the price can indeed be influenced by several elements, such as market conditions, contractual conditions (the existence of secondary benefits, the quantity of goods sold, terms of payment), the commercial strategy or the economic functions of the parties. *(Switzerland)*
- The price charged in a comparable transaction is presumed to correspond to the the market price; in case of dispute, proof to the contrary lies with the company. *(Switzerland)*
- The Federal Supreme Court disallows transfer of tax losses where the absorbed subsidiary is an empty shell without any economic activity. *(Switzerland)*
- Regarding non-cash benefits, the rule is that the tax authority is responsible for proving that the company has rendered a service and that it has no or unreasonable consideration in return. *(Switzerland)*
- If the tax authority demonstrates such a mismatch between performance and consideration, the taxable company shall rebut the presumption; otherwise, it shall bear the tax consequences. *(Switzerland)*

Takeaways: Burden of Proof (Part 3)

- The Italian Supreme Court established that transfer pricing legislation is included among the anti-avoidance provisions, as it is addressed to fight the transfer of income from one country to another by "manipulating" the intra-group costs. *(Italy)*
- Consequently, the burden of proof lies with the Italian tax authorities, which should prove the grounds for the adjustment. *(Italy)*
- However, as the sharing of intra-group costs also involves the matter of whether the costs exist and are pertinent, the burden of proof of the costs lies with the taxpayers. *(Italy)*
- The Italian Supreme Court have drawn a distinction between cases regarding income, and cases regarding expenses. In cases regarding income, the burden of proof lies with the tax authorities. In cases regarding costs, the burden of proof lies with the taxpayer. *(Italy)*
- The tax administration does not have to prove existence of tax evasion, but only the existence of transactions between affiliated companies. *(Italy)*
- The taxpayer must prove that the transactions have been priced at market values deemed to be "normal". *(Italy)*

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TAKEAWAYS: TRANSFER PRICING METHODS (PART 1)

- The selection of the best method should be based on functional analysis and the characterization of transactions and entities. *(India)*
- A proper functional analysis of the tested party and the comparables is needed in determining the arm´s length price, while the selection of comparables merely on the basis of business classification provided in the database is not acceptable. *(India)*
- The arm’s length principle as determined by either the taxpayer or the tax authorities cannot lead to manifestly absurd or abnormal financial results. *(India)*
- If other transactions are relevant in determining whether transfer prices are reasonable, these transactions should be taken into account. *(Canada)*
- When related companies are acting as distributors, the comparison with the pricing applied to third party customers is considered inappropriate for the purposes of assessing an arm´s length dealing. *(France)*

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Takeaways: Transfer Pricing Methods (Part 2)

- To determine the arm´s length interest on loans, the relevant market for comparability is that of the seller. *(Italy)*
- In determining normal value, reference must be made – to the extent possible – to price lists or tariffs of the party which has supplied the goods and services or, if necessary, to the indices and price lists of the Chamber of Commerce and to professional tariffs, taking normal discounts into account. *(Italy)*
- If the pricing of internal sales shall be deviated, the tax authorities shall still be bound by the general tax rules, including the guidelines from the OECD on transfer pricing, which do not prohibit the use of information unknown to the taxpayer, but do call for caution as to how the information is used, so that the taxpayer is given a reasonable opportunity to defend itself, and judicial oversight is ensured. *(Norway)*

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Takeaways: Transfer Pricing Methods (Part 3)

- Capacity utilization risk should be absorbed by the principal and not the low risk toll manufacturer. A low risk toll manufacturer may only end up in a loss position if extra costs result from its own risks – manufacturing inefficiencies. *(Czech Republic)*
- For determining the arm's length price of international transaction, it is important to take the characterization of the taxpayer and the related party into consideration through a functional analysis, observing the following specifically: *(India)*

   1. Assumption of significant business risks.
   2. Capacity to assume business risks.
   3. Development of human resource intangibles.
   4. Development of supply chain intangibles.
   5. Location savings attributable to the taxpayer.

Takeaways: Intragroup Services (Part 1)

- To satisfy the arm's-length standard, a charge for intra group services or intangibles must at least meet the following conditions: *(India)*
  1. The need for intra group services or intangibles is established.
  2. The intra group services or intangibles have actually been received.
  3. The benefit from intra group services or intangibles is commensurate with the charge.
- The taxpayer is obliged to prove the relationship of the expensed service fees to its taxable income. Tangible evidence of the provided services, including reports, correspondence and confirmation of business trips should be provided by the taxpayer in order to prove the actual provision of the services. *(Czech Republic)*
- This case confirms the strong position of tax authorities when challenging the transfer prices of services. If the taxpayer does not meet the benefit test (proving that the services were actually rendered and incurred in relation to its taxable income), the entire service expense is non-deductible. *(Czech Republic)*

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TAKEAWAYS: INTRAGROUP SERVICES (PART 2)

- Costs incurred in the interest of another company are not tax deductible. *(France)*
- It is necessary to give evidence that a company has actually received a service and that this service is objectively definable and documented in order to deduct the expense. *(Italy)*
- A company can only deduct the fees if it can prove that: *(France)*
    1. The services provided are real.
    2. The services are not duplicates.
    3. The price of the services comply with the arm's length principle.
- The mark-up on the service charges should not be determined on the basis of the level of profits in third-party comparables. The profit should be determined on the basis of the benefits from the services to related companies that received the services. *(Finland)*

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Takeaways: Financing Transactions (Part 1)

- A cross guarantee is an arrangement that originates from shareholder interests. Hence a credit loss resulting from a cross-guarantee agreement is not deductible for tax purposes. *(Netherlands)*
- The rate on the short-term deposits and the corresponding loans (borrowed due to insufficient liquidity management) arising from a cash pool arrangement should be the same. There is very little or no creditor risk on these gross corresponding loans/deposits because of the possibility of offsetting the balance. Hence, there is no basis for a spread on the gross balance. *(Denmark)*
- The fact that OECD Transfer Pricing Guidelines could in theory have allowed a reclassification of the legal form of the loan into equity is not relevant because a tax treaty cannot broaden the tax base from that determined under the domestic tax provisions. *(Finland)*
- If the terms of inter-company loans are not conforming to market conditions, then the payment qualifies as a distribution and a special reserve must be made in the balance sheet of the lender. *(Switzerland)*
- It is questionable whether a participation in the cash pool, by which the participant disposes of its liquidity, can pass the market conditions test at all. *(Switzerland)*

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Takeaways: Financing Transactions (Part 2)

- The Federal Supreme Court denied the beneficial ownership on the grounds that the Danish bank was, in fact, obliged to transfer the dividends to the respective parties of the total return swap agreements. *(Switzerland)*
- Related-party loan losses can only be deducted if a third party creditor would have granted the finance (or allowed it to remain outstanding) under otherwise similar conditions. *(Germany)*
- The interest limitation rule does not meet the constitutional requirements of equal treatment and consistency of application. *(Germany)*
- The interest limitation is an exception to the general principle of taxing the net profit of a company and, as an exception, it must be clearly formulated. *(Germany)*
- The exception for interest payments to a significant shareholder of not more 10% of the company's total borrowing cost applies separately for each shareholder, rather than to all significant shareholders cumulatively. *(Germany)*

TAKEAWAYS: FINANCING TRANSACTIONS (PART 3)

- Intra-group financing agreements are subject to transfer pricing legislation and non-interest-bearing financing is generally not consistent with the arm's-length principle. *(Italy)*
- A prerequisite for applying the correction rule is that the company's earnings have been lowered as a result of terms being agreed which differ from what would have been agreed between independent parties. It is thus the effect of the earnings that must be assessed and not how a single income or expense item has been affected. *(Sweden)*
- The correction rule can be applied when a contract with a certain condition is replaced by an agreement with a worse condition. Such an interpretation of the correction rule is considered compatible with the OECD Guidelines. *(Sweden)*
- every agreement in which the lender is obligated to transfer ownership of a specified amount of funds to the borrower, and the borrower is obligated to return the amount and pay interest, even if obligations of the parties to the agreement are implicit, constitutes a loan agreement. *(Poland)*

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TAKEAWAYS: FINANCING TRANSACTIONS (PART 4)

- In order to achieve an arm's length price, the comparison must take into account all characteristics of the controlled transaction except the parties' association with each other. *(Norway)*
- If the tax authorities have solved a classification or allocation issue for a transaction in the same way for several income years, and there is a final and enforceable judgment for one of the years, the provision gives the tax authorities the right and obligation to also consider the tax assessments for the other years. *(Norway)*
- According to Dutch case law the main characteristic of an extreme default risk (EDR) loan is that an arm's length interest rate cannot be found – the shareholder grants the loan under such circumstances that it is clear from the outset that it cannot be repaid and the shareholder does not have business interest, other than in its capacity as shareholder, to grant the loan. "Parallel" deduction of a write-down loss in respect of an extreme default risk loan is not possible. *(Netherlands)*

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Takeaways: Financing Transactions (Part 5)

- Based on the non-statutory anti-avoidance rule in Norwegian Tax Law, a parent company cannot be allowed to deduct the interest on the inter-company loan if the main purpose of the reorganization is considered to be to save tax. *(Norway)*

- A portion of a cash pool receivable has to be treated as a long-term loan bearing higher interest rates. The long-term loan is set to the minimum cash pool receivable balance of each fiscal year. *(Switzerland)*

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Takeaways: Intangibles & Royalties (Part 1)

- If there is an agreement between the group parent and the taxpayer which carries an obligation on the taxpayer to use the trademark owned by the group parent. Such agreement should be accompanied either by an appropriate payment by the group parent or by a discount provided to the taxpayer. Appropriate payment should be made on account of benefit derived by the group parent in the form of marketing intangibles obtained from such mandatory use of the trademark.*(India)*

- Cost sharing arrangement (CSA) payments relating to research, design, and development (R&D) are "in respect of" the goods sold for export and thus part of the "price paid or payable" for the goods for customs purposes. *(Canada)*

- The mere use of the group name in the company registration of a subsidiary – including the right to trade under that name – does not give rise to a royalty entitlement of the parent. Such entitlement only arises in connection with other associated rights, such as the use of a logo or technology, in which case, the benefit from the use of intangibles should be seen as a package. *(Germany)*

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TAKEAWAYS: INTANGIBLES & ROYALTIES (PART 2)

- Goodwill amortizations should not be included when comparing the operating income of the company to the operating income of independent parties in a database survey. *(Denmark)*
- Tax administration is not entitled to make an estimated assessment under Danish tax law, where the TP documentation provides a sufficient basis for assessing whether prices and terms are in accordance with the arm's length principle. *(Denmark)*
- In the event of a transfer of shares, the goodwill recognized at the acquisition of the shares shall no longer be included in the balance sheet of the parent company. *(France)*

Takeaways: Business Restructuring

- Payment of a termination fee must have sufficient connection to the company's income acquisition for the payment to be tax deductible. *(Denmark)*
- A company cannot be deemed as an independent agent if it operates exclusively for a related company under control and instructions from the same. *(Spain)*
- Considering a company as a PE is not only its capacity to conclude contracts that bind the company but also the functional and factual correlation between the agent and the company in the sense that the agent has sufficient authority to bind the company in its day to day business, following the instructions of the company and under its control. *(Spain)*
- Regarding the “fixed place of business”, having a place at the principal’s disposal also includes the use of such premises through another entity which carries out the principal’s activity under its supervision. *(Spain)*
- A taxpayer fulfills its legal obligations by preparing thorough transfer pricing documentation, in which case the burden of proof is on the tax authorities. *(Netherlands)*

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TAKEAWAYS: MAP & APA

- The costs incurred by a taxpayer in connection with a tax treaty mutual agreement proceeding are not costs of earning the relevant income, but has left open a possible deduction as “unusual expenses”. *(Germany)*

- A settlement agreed to via the competent authority precludes a subsequent tax-reassessment that attempts to further increase the taxpayer’s income. *(Canada)*

- The German Customs Code, in the version in force, must be interpreted as meaning that it does not permit an agreed transaction value, composed of an amount initially invoiced and declared and a flat-rate adjustment made after the end of the accounting period, to form the basis for the customs value, without it being possible to know at the end of the accounting period whether that adjustment would be made up or down. *(European Union Court of Justice)*

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USEFUL RESOURCES

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This presentation highly benefitted from the following resources and databases:

- Website TP Cases: https://tpcases.com - This website was the primary source of cases for the current presentation. Full texts and translations of cases are available in this website.
- Website Transfer Pricing Network: http://www.transferpricing.com/courtcases.htm - This website focuses and compiles US and Canadian cases. Also, it contains a wide variety of worldwide resources.
- Digest of Important Judgments on Transfer Pricing: http://itatonline.org/articles_new/digest-of-important-judgements-on-transfer-pricing-international-tax-and-domestic-tax-april-2017/
- Website TP Taxsutra: http://www.tp.taxsutra.com - Special reference to the Case Tracker.
- Ca Narendra Jain: "Analysis of Transfer Pricing Judgements", Wolters Kluwer, 2nd edition.

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