



JÖNKÖPING INTERNATIONAL
BUSINESS SCHOOL
JÖNKÖPING UNIVERSITY

Developing a transfer pricing system

A case study of a company in the marine foodservice industry

Master's thesis within Transfer Pricing

Author: Elin Andersson

Tutor: Hubert Hamaekers

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Master's Thesis in Transfer Pricing

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Author: Elin Andersson

Tutor: Hubert Hamaekers

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Abstract

Marine Food group is active within the marine foodservice industry and is established in Finland, Sweden, USA and Singapore. The group both sells galley equipment and spare parts as well as carrying out installation of the marine foodservice areas in both new build vessels and in vessels where an old galley is changed into a new one. The group also provides its customers with turnkey deliveries, which are when the supplier has the overall responsibility for the delivery of a marine foodservice area. Marine Food group transfers goods and services between the enterprises situated in Finland, Sweden and the US and has not established a transfer pricing system for these transactions. The company located in Singapore was recently established and any intra-group transactions have not been conducted yet. This master's thesis aims at developing a transfer pricing system that could be applicable on these transactions and acceptable to the tax authorities in Finland, Sweden and the US.

The elements that should be included when developing a transfer pricing system is functional analysis, economic analysis, an analysis of transactions, selection of transfer pricing method and comparables. The Marine Food group is therefore analyzed based on these elements in order to be successful in developing a transfer pricing system. Furthermore, the transfer pricing rules in Finland, Sweden and USA is examined in order to develop a transfer pricing system that is acceptable to the tax authority in respective country. The Organization for Economic Co-operation and Development has issued Transfer Pricing Guidelines, which are another significant source that are examined when establishing a transfer pricing system for Marine Food group.

Spare parts are transferred between the Swedish company, Marine Food AB and the US based company, Marine Food LLC. The transfer pricing method that should be applied in Sweden is the resale price method since Marine Food LLC operates like a reseller for the spare parts. Internal comparables exist and comparability for the purposes of resale price method can be established with reference to both internal and external data. In the US, the comparable profit method should be applied given that it meets the best method rule.

The transactions from the Finnish Company, Marine Food Oy and the Swedish company, Marine Food AB consist of installation works and stainless steel furniture. Hence, the transactions both involve goods and services and should be looked at separately. The transfer price for the installation works should be set by using the transactional net margin method. In order to determine the transfer price under the transactional net margin method both internal and external comparables can be used in this case. The transfer price for the stainless steel furniture should on the other hand be established using the resale price method. In order to determine comparability external comparables are used due to lack of internal data.

Marine Food AB sells galley equipment and spare parts to Marine Food Oy. The transfer pricing method that should be applied on these transactions is the resale price method since the least complex party in the transaction, Marine Food Oy, act like a reseller of the galley equipment and spare parts. Comparability is to be established with reference to external comparables since internal comparables do not exist.

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Abbreviations

| | |
|-------------------|---|
| AB | Aktiebolag (Swedish analogy to Limited Liability Company) |
| Art. | Article |
| CFA | Committee of Fiscal Affairs |
| Ch. | Chapter |
| CPM | Comparable Profit Method |
| CUP | Comparable Uncontrolled Price Method |
| edn. | Edition |
| e.g. | Exempli gratia |
| EUR | Euro |
| HE | Hallituksen Esitys (Finnish Preparatory Act) |
| Ibid. | Ibidem |
| IL | Inkomstskattelagen (Swedish Income Tax Act) |
| IRC | Internal Revenue Code |
| IRS | Internal Revenue Service |
| LLC | Limited Liability Company |
| MNE | Multinational Enterprise |
| No | Number |
| OECD | The Organization for Economic Cooperation and Development |
| Oy | Osakeyhtiö (Finnish analogy to Limited Liability Company) |
| p | page |
| para | paragraph |
| PLI | Profit Level Indicator |
| Prop | Proposition (Swedish Preparatory Act) |
| Proposed revision | Proposed revision of Chapter I-III of the Transfer Pricing Guidelines 9 September 2009 – 9 January 2010 |
| PSM | Profit Split Method |
| Pte | Private |
| R&D | Research and Development |
| Ref. | Referat (Swedish expression for Report) |
| Regs. | Regulations |

| | |
|------|---|
| RPM | Resale Price Method |
| RÅ | Regeringsrättens årsbok (Swedish Supreme Court of Administrative Appeal) |
| S/S | Stainless Steel |
| Sec. | Section |
| SEK | Svensk krona (Swedish currency) |
| TNMM | Transactional net margin method |
| TPG | Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations |
| US | United States |
| USD | US Dollar |
| USPH | United States Public Health Department |
| VML | Valitovarainministeriön päätös (Finnish Act on Tax Assessment Procedure) |
| Vol | Volume |
| vp | Valtiopäivä (Finnish Parliament) |

I Introduction

I.1 Background

The international trade is increasing and almost 70% of the cross-border trade in the world is taking place between related enterprises.¹ The price negotiated between two related enterprises that trade goods, services or intangible property with each other is defined as a transfer price.² Transfer prices determine to vast extent the taxable profits of the related enterprises and are therefore significant both for the taxpayers and the tax authorities.³ When transactions are taken place across borders within a multinational enterprise (MNE)⁴ taxation problems may occur both for the tax authorities and the enterprises themselves.⁵ Transactions carried out within a MNE can be made under special conditions in order to increase the related enterprises' competitiveness and advantages compared to its competitors.⁶ Hence, related enterprises have an advantage compared to independent enterprises.

In order to solve the issue with eliminating special conditions for MNEs and establishing accurate transfer prices the member countries of the Organization for Economic Co-operation and Development (OECD) have adopted the arm's length principle.⁷ The arm's length principle was developed in a report by the OECD Committee on Fiscal Affairs (CFA) and is described in Article (Art.) 9 of the OECD Model Tax Convention.⁸ The arm's length principle has been chosen by the OECD member countries to ensure that each and every tax base is protected from erosion due to MNEs shifting profits between jurisdictions. Avoiding double taxation is another reason why the arm's length principle has been adopted. By applying the arm's length principle correctly these dual objectives will be fulfilled.⁹

Today, a vast number of countries have addressed the transfer pricing issues and imposed regulations including penalties and documentation requirements.¹⁰ Transfer pricing related discussions between tax authorities in different jurisdictions are becoming more common with sharing information, sharpening their enforcement focus and adopting important practices. Tax authorities are also adjusting their policies and strategies and developing im-

¹ Hamaekers, Hubert, 'The Arm's length – How long?', van Reed, Kees (ed), *International and Comparative Taxation – Essays in Honour of Klaus Vogel*, (London, Kluwer International Ltd, 2002) p. 29.

² OECD documents, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG), Preface, para. 11.

³ Ibid., para 12.

⁴ According to TPG, Glossary a MNE can be defined as: "A group of associated enterprises with business establishments in two or more countries".

⁵ TPG, Preface, para 1.

⁶ Ibid., para. 6.

⁷ Ibid.

⁸ OECD documents, Transfer pricing and multinational enterprises: report of the OECD Committee on Fiscal Affairs, (Paris 1979).

⁹ TPG, Preface, para. 7.

¹⁰ Levey, Marc, Wrappe, Steven, *Transfer Pricing: Rules, Compliance and Controversy*, 2nd edn, (Chicago CCH, 2007), p. 26-27.

proved tools, processes and capacities. Generally, transfer pricing resources are increasing in many countries. For example, Finland has a team of almost 45 transfer pricing experts and their transfer pricing provisions regarding documentation were enforced only two years ago. Moreover, several countries tend to set up specialist transfer pricing examination teams. This trend is most likely to result in increased audits from tax authorities.¹¹ In addition to increased audits, transfer pricing penalties are also expected to rise.¹²

MNEs have to encounter their tax obligations at the same time as coming under greater investigation. MNEs are therefore assigning more time and resources to tackle audits by tax authorities. Managing the transfer pricing issues effectively is more important and more challenging than ever before.¹³ The development within the transfer pricing area has led to that the question is generally not if taxpayers will be inspected, but rather when they will be inspected. Consequently, MNEs are no longer able to ignore the issue of transfer pricing.¹⁴

Marine Good group is a fairly young corporate group with an undeveloped transfer pricing strategy. Marine Food group is privately owned and has its headquarters in Finland with subsidiaries in Sweden, USA and Singapore. The group is specialized within the marine foodservice areas, which include galley equipment and spare part sales, installation works, bar and other catering areas, cold/freezer rooms and also provision stores. As the corporate group is situated in several countries it is important to develop a transfer pricing system that is acceptable to the tax authorities in the different countries.

1.2 Purpose and Approach

The purpose of this master thesis is to develop a transfer pricing system that is applicable on the transactions between the companies within Marine Food group that are established in Finland, Sweden and USA and acceptable to the tax authorities in respective country.

The purpose is to be approached by comparing and analyzing the transfer pricing rules in Finland, Sweden and USA in order to establish a transfer pricing system acceptable to the tax authorities in respective country.

1.3 Method

The thesis will be written with a combination of two methods; the traditional legal method and to some extent the comparative method. The traditional legal method means that sources of law in different legal systems are examined and analyzed hierarchically.¹⁵ This method is applied in order to distinguish the legal position in the transfer pricing area and will be used in the thesis when examining the Finnish, Swedish and the American transfer pricing rules separately.

By using a comparative method one compares legal systems of different nations. The comparison can be made on a large or a small scale.¹⁶ Studying the essentials of the foreign legal

¹¹ Ernst & Young, 2009 *Global transfer pricing Survey*, p. 6.

¹² Ibid., p. 8.

¹³ Ibid., p. 6.

¹⁴ Levey, Marc, Wrappe, Steven, *Transfer Pricing: Rules, Compliance and Controversy*, p. 27.

¹⁵ Zweigert, Konrad, Kötz, Hein, *An Introduction to Comparative Law*, 3rd edn, (Norfolk, Oxford University Press, 1998), p. 35-36.

¹⁶ Ibid., p. 4.

systems and then comparing the material critically in order to determine a policy to adopt is the best way of conducting a comparative study.¹⁷ The author uses the comparative method in this way to compare the transfer pricing rules in order to develop a transfer pricing system that is acceptable to the tax authorities in respective country and thereby fulfill the purpose of this thesis. The comparative method is consequently used when comparing the Finnish, Swedish and American transfer pricing rules in order to determine a transfer pricing method, which is satisfactory to the Finnish, Swedish and American tax authorities.

The Swedish transfer pricing rules has been easy to access and understand since the author is well oriented and familiar with the Swedish legal system. According to the Finnish linguistic law¹⁸ the national language in Finland is both Finnish and Swedish.¹⁹ The most of the material regarding the Finnish transfer pricing rules is therefore accessible in Swedish why the author has not found it difficult to find gather relevant information. Due to lack of experience and training of the US legal system the author has found it troublesome in finding primary sources. However, helpful guidance has been obtained in doctrine and the author has found it possible to distinguish the legal position in order to be able to compare the relevant transfer pricing rules.

To be able to suggest an appropriate transfer pricing system one needs to gather extensive information about the corporate group in question. The data is therefore collected with the aim of making a proper analysis and to suggest a suitable transfer pricing system and hence fulfilling the purpose of this thesis. Given that the thesis is based on an actual case the author has interviewed the vice President and Chief Financial Officer in one of the enterprises in order to gather information and learn about the corporate group. Information is to great deal also gathered from a MBA written in 2009 by the interviewed person.

The Transfer Pricing Guidelines (TPG) of OECD are not binding for the Member Countries. However, it is recommended that the Member Countries follow these when dealing with transfer pricing issues.²⁰ Even though OECD is not a legislative organization the TPG are an important source within in the field of transfer pricing which needs to be examined when writing this thesis.

I.4 Delimitations

This master's thesis is based on an actual case and will therefore examine transfer pricing rules applicable to the circumstances in that specific case. The transfer pricing rules of Singapore will not be examined since transfer pricing transactions have not yet been conducted between the company established in Singapore and the other companies in Marine Food group. Due to the scope of this thesis only transactions regarding transfers of goods and services will be examined. The documentation rules of the countries studied will therefore not be analyzed. Neither will the penalties, that may be imposed when not complying with the transfer pricing rules in the different countries, be studied. When it comes to services, cost sharing arrangements will not be discussed since it is not relevant due to the circumstances of this case study. Furthermore an actual database search will not be made but the theoretical parts of it will be discussed. Due to the scope of this master's thesis the author

¹⁷ Zweigert, Kötz, *An Introduction to Comparative Law*, p. 6.

¹⁸ Kielilaki 6.6.2003/423

¹⁹ Kielilaki, Ch. 1, § 2.

²⁰ TPG, Preface, para 16.

will not go into depth on different vessel types in the industry analysis. Furthermore, the competitor analysis will not reveal the name of the various competitors to Marine Food group.

1.5 Terminology

The term *Galley* is frequently mentioned in this thesis and means kitchen or kitchenettes in vessels.

The term *Marine Food* is used when describing the different enterprises in the corporate group that is the base of this thesis. The corporate group exists under another name but with respect to the corporate group and for integrity reasons as well as the risk of revealing corporate secrets the term Marine Food will be used throughout the thesis.

1.6 Outline

This master's thesis consists of ten chapters where the following eight chapters are descriptive and the last two chapters include analysis and conclusion.

Chapter 2 contains information about the methodology of developing a transfer pricing system, which gives the reader an understanding of which steps are necessary and what to consider when developing a transfer pricing system.

Chapter 3 investigates the Marine Food group closely, which is the base for this master thesis. The aim with this chapter is to provide relevant information about the Marine Food group for the later analysis.

Chapter 4 examines the transfer pricing area from the OECD's point of view. The transfer pricing methods recommended by the OECD are discussed in detail. Furthermore the relevant parts of the Proposed revision are investigated.

Chapter 5, 6 and 7 include country specific information about the countries where the Marine Food group is established which are Sweden, Finland and the US. Chapter 8 compares the transfer pricing rules of these countries.

Chapter 9 analyses the transactions within the Marine Food group and discuss what transfer pricing method and comparables that could be applicable on those transactions.

Chapter 10 is a conclusion and recommendation of the transfer pricing system that should be developed for Marine Food group.

2 Developing a transfer pricing system

2.1 Introduction

A transfer pricing system that is reasonable and sustainable for MNEs as well as acceptable to the tax authorities where MNEs are located requires knowledge about the methodology of developing a transfer pricing system. This chapter will look at how to develop a durable transfer pricing system and what steps enterprises should take to be successful in establishing such a system.

2.2 Process

In order to apply the arm's length principle the results of a transaction between related enterprises must be compared to the results derived from comparable transactions between unrelated enterprises under comparable circumstances.²¹ Hence, the main principle when transferring goods or services within MNEs is comparability. The Proposed revision to the OECD TPG suggest a 10 step process that could be a good starting point when determining comparability. According to the Proposed revision this process is not compulsory in order to establish transfer prices that are at arm's length. The outcome is more important than the process itself.²² Information from the IBFD Transfer Pricing Database also states some steps that are necessary in order to establish a transfer pricing report.²³ The essential steps that both these sources advocates are functional analysis, economic analysis, analysis of the controlled transactions, selection of method and comparables.

2.2.1 Functional analysis

When developing a transfer pricing system, one requirement is typically a functional analysis. The purpose of a functional analysis is to gather information and organize relevant data to analyze transfer prices.²⁴ Through a functional analysis the functions, risks and assets of the related enterprises are identified and end up in a characterization of the enterprises.²⁵ The functional analysis can be conducted through questionnaires, interviews or/and checklists. The way the analysis is carried out is less important than the outcome, which must clearly identify which enterprise performs each function, bear each risk and employ each asset.²⁶ The functional analysis should also reveal which group member in the transactions

²¹ Linwood Smith, J, 'Overview of the Transfer Pricing Analysis Process', Parker, Kenneth R.L, (ed), *Tax Director's Guide to International Transfer Pricing*, (Newton, Global Business Information Strategies, Inc., 2008) p. 14.

²² OECD Documents, Proposed revision of Chapter I-III of the Transfer Pricing Guidelines 9 september 2009 – 9 January 2010, para. 3.5.

²³ Information from IBFD Database, please see under General, Introduction to transfer pricing, Selection of method/Search for comparables.

²⁴ Amerkhail, Valerie, *"Functional Analysis and Choosing the Best Method"*, Cole, Robert T, (ed), Practical Guide to U.S Transfer Pricing (Washington, Mattheew Bender and Company Inc, 2006), para 12.02.

²⁵ Ibid., para. 12.01.

²⁶ Ibid., para. 12.02.

concerned creates the value and which of the related enterprises that carries out the routine profit and therefore is the “least complex entity”.²⁷

2.2.2 Economic analysis

An economic analysis should contain information about the industry, the relevant market and the competition on the market. Elements that should be taken into consideration are for example the geographical market, development of the market, market share and published details of similar transactions.²⁸

2.2.3 An analysis of transactions

It is important to have a great understanding of the transactions between the various group members. An analysis of the transactions should therefore be made including information about the characteristics of the product or service transferred, the contractual terms of the transaction and whether transactions on similar goods are carried out with non-related companies or not.²⁹

2.2.4 Selection of method

When the three above mentioned analysis are completed they provide material for a preliminary choice of method.³⁰ Different jurisdictions have different principles when selecting transfer pricing method. A multi-jurisdictional transfer pricing study might therefore lead to application of more than one transfer pricing method to the same fact pattern.³¹ Thus, it should be investigated which methods respective country advocates and this basis along with the functional analysis should be guiding when selecting method on the transactions between the related enterprises.

2.2.5 Comparables

Once a transfer pricing method has been selected, based on the functional and economic analysis together with the analysis of transactions, the OECD TPG and many other countries require justification with reliable comparables.³² The definition of comparable is according to the OECD TPG:

*“- None of the differences (if any) between the situations compared could materially affect the condition being examined in the methodology (e.g. price or margin), or
- reasonably accurate adjustments can be made to eliminate the effect of any such difference”*³³

²⁷ Information from IBFD Database, please see under General, Introduction to transfer pricing, Selection of method/Search for comparables, The selection process.

²⁸ Ibid.

²⁹ Ibid.

³⁰ Proposed revision, para. 3.5 & Information from IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of method/Search for comparables, The selection process.

³¹ Linwood Smith, J, ‘Overview of the Transfer Pricing Analysis Process’, Parker, Kenneth R.L, (ed), *Tax Director’s Guide to International Transfer Pricing*, p. 15.

³² Information from IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of method/Search for comparables, The selection process.

³³ TPG, para. 1.15.

A similar standard is laid down in the US Regulations. It states that the uncontrolled transaction may not be exactly equal to the uncontrolled transaction but must be adequately similar to give a reliable arm's length result. Material differences in the comparisons must be adjusted in order to enhance the reliability of the results. If such adjustments can not be made, the uncontrolled transactions may however be used as a measure of an arm's length result. The reliability of the analysis will although be decreased.³⁴

The comparables can either be internal or external. The primary source for potential comparables should always be internal data.³⁵ Internal comparables are taken from transactions between one related party and a non-related party.³⁶ If adequate internal comparables can not be found, the following step is to search for external comparables.³⁷ External comparables are derived from prices or profits, which have been charged, paid or obtained in the open market outside the tested related enterprise.³⁸

The search for external comparables should be made in publicly available databases. The first broad result from a database search must be reduced based on the chosen comparables. After a completed search the result may require adjustments if material differences exist. For example, included costs may not be completely comparable if the related enterprise does not charge its customers for transportation costs, while the compared enterprise does charge its customers for such costs. If the margin of the taxpayer is within the arm's length range, further benchmarking may not be needed.³⁹ The analysis of available sources may sometimes influence the choice of the transfer pricing method. For example, in situations where it is not possible to gather information on comparable transactions and/or making adjustments for material differences another transfer pricing method may have to be selected and the process of finding comparables starts over again.⁴⁰

When possible comparables have been found, comparability should be established. Sometimes it can be difficult, both for the taxpayer and the tax authorities, to find close comparables not only from internal comparables but also from public available databases. However, the aim is to obtain the best comparables given the limitations in the data.⁴¹ According to the OECD TPG and US Regulations there are different factors that determine comparability. The US regulations states that these factors are functions, contractual terms, risks, economic conditions and characteristics of a product or a service.⁴² The OECD TPG advo-

³⁴ US Regs., 1.482-1 (d) (2).

³⁵ Linwood Smith, J, 'Overview of the Transfer Pricing Analysis Process', Parker, Kenneth R.L, (ed), *Tax Director's Guide to International Transfer Pricing*, p. 20.

³⁶ TPG, para. 2.13, 2.15, 2.33, 3.24, 3.26.

³⁷ Linwood Smith, J, 'Overview of the Transfer Pricing Analysis Process', Parker, Kenneth R.L, (ed), *Tax Director's Guide to International Transfer Pricing*, p. 20.

³⁸ TPG, para. 2.15, 2.33, 3.25, 3.26.

³⁹ Information from IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of method/Search for comparables.

⁴⁰ Proposed revision, para. 3.6.

⁴¹ Linwood Smith, J, 'Overview of the Transfer Pricing Analysis Process', Parker, Kenneth R.L, (ed), *Tax Director's Guide to International Transfer Pricing*, p. 20.

⁴² US Regs., 1.482-1 (d) (1).

cate more or less the same factors but also embrace business strategies.⁴³ A lot of this information has been attained under the functional analysis, the economic analysis and the analysis of the transactions. The importance of each factor depends on the method applied.⁴⁴ The *functions* performed and associated resources employed by the related enterprises in the transactions are necessary to compare.⁴⁵ The structure and organization of the corporate group shall particularly be considered. Factors such as design, manufacturing, research and development, servicing, purchasing, distribution, marketing, advertising, financing and management needs to be identified and compared.⁴⁶ When comparing the functions performed it could be important to consider assets used by the parties. The risks assumed by the respective parties are also a significant factor of the functional analysis since the allocation of risks would affect the conditions of transactions between related enterprises.⁴⁷ An analysis of the *contractual terms* should be a part of the comparison since differences in the contracts may significantly affect the comparability. Contractual terms that may differ could be sales or purchase volume, payment, credit and delivery terms.⁴⁸ The arm's length price for transactions regarding the same type of property or service may vary in different markets. *Economic circumstances* like the relevant market/s, geographic location, the size of the markets, the relevant market shares for the products transferred or provided, the level of supply and demand in the market as a whole and in particular regions needs to be examined to determine the comparability.⁴⁹ *Characteristics of property or service* that may be important to consider when comparing transactions contain the quality, reliability and durability of the goods or services being transferred.⁵⁰ In order to determine comparability for tax purposes *business strategies* also needs to be examined. Many factors of an enterprise may have to be considered when investigating business strategies. Product development and innovation, assessment of political changes, market penetration schemes are examples of business strategies that can be analyzed to determine comparability.⁵¹

⁴³ TPG, para. 1.19 – 1.35.

⁴⁴ Information from IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of method/Search for comparables.

⁴⁵ TPG, para. 1.20.

⁴⁶ Ibid., para. 1.21.

⁴⁷ Ibid., para. 1.20-1.23.

⁴⁸ Ibid., para. 1.28.

⁴⁹ Ibid., para. 1.30.

⁵⁰ TPG, para. 1.19 & Adams, Chris, Graham, Peter, *Transfer Pricing: A UK Perspective*, (London, Butterworths, 1999) p. 9.

⁵¹ TPG, para. 1.31-1.32.

3 Marine Food group

3.1 Introduction

As mentioned in previous chapter a functional and economic analysis as well as an analysis of the controlled and uncontrolled transactions are essential elements when developing a transfer pricing system. This chapter investigates the Marine Food Group closely based on those elements.

3.2 Functional analysis

This section starts with history of Marine Food group followed by a description of the products the group works with. The business operations of the Marine Food group are then shortly described and the section ends with a figure that allocates and describes the different functions, risks and assets within the group.

3.2.1 History of Marine Food group

Marine Food Oy, a Finnish based company was founded 1977 and has installed marine foodservice areas in over 150 passenger vessels since the mid eighties which makes them the leading company in the marine foodservice market. The company established a Swedish based subsidiary, Company AB, in 2003 when it took over the marine division of a Swedish manufacturer of kitchen devices. This establishment led to the completion of their services as one-stop shop for all marine customers regarding foodservice areas and also entering into the merchant ship galley equipment market. In 2004 Marine Food AB established a subsidiary, Marine Food LLC, in Ft Lauderdale, USA with the aim of providing better service to their US based customers. The US based subsidiary primarily works with after sales services for passenger vessels in the USA. Due to a market recession with significant downturns in order intake, Marine Food AB sought new business opportunities in the after sales market. The company therefore established a subsidiary in Singapore in 2009, which has one of the busiest ports in the world and an operative shipyard industry, with the aim of targeting that market.⁵²

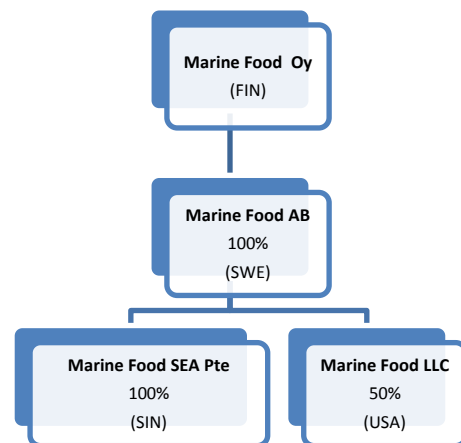


Figure 3-1 Marine Food group structure April 2009 (excluding holding and real estate companies)

⁵² Lehtinen, Teea, *Strategic Overview of a company in marine foodservice industry* – (Copenhagen Business School, Executive MBA in Shipping and Logistics Integrating Strategy Project, 2009), p. 43-45.

3.2.2 Products

The marine foodservice areas differ from kitchens, restaurants and bars on shore. These differences can be attributed to elements such as electrical sources, hygienic standards and regulations that are stricter for vessels and offshore installations as a result of its susceptibility to accidents, fires and disease spreading. Occupational Health and Safety has regulations that are valid for all on-shore kitchens and in order to conform to these regulations some countries have enforced similar recommendations for off-shore kitchens as well.⁵³

The United States Public Health (USPH) Department has empowered the strictest recommendations that apply for all vessels carrying passengers. Vessels must meet these safety recommendations in order to dock in the US territory. The recommendations control for example the moving arrangements of food and gear inside galleys and give also detailed guidelines regarding installation with the aim of reducing dirt and germs in the food preparation areas.⁵⁴ Hence, on-shore kitchen equipment differs to a vast extent from galley equipment, which mostly is due to safety regulations. Other technical differences are listed in Appendix 1⁵⁵.

Installation work can be delegated from shipyards to one sub-contractor as a turnkey contract. Turnkey deliveries⁵⁶ consist of series elements from layout design, installation drawings, project management, installation of equipment and finally commissioning. Shipbuilders can also share different installation functions between several companies that are specialized in their own niche. These different types of installation methods require different types of organization from the shipyard.⁵⁷

Marine Food group is, as mentioned in the background, specialized in marine foodservice areas. These areas include various sections such as galleys, pantries, bars, storage areas, spare parts and galley equipment. In order to understand the business operations, the transactions, the functions and risks within group as well as the market along with the competition the broad definition is divided into two parts:⁵⁸

1. Galley Equipment and spare part sales
2. Installation of foodservice areas

3.2.3 Overview of the business operations by Marine Food group

Marine Food group both sells galley equipment and spare parts as well as carrying out installation of the marine foodservice areas in both new build vessels and in vessels where an old galley is changed into a new one. The group does not produce the galley equipment and spare parts itself but buys them from several different suppliers. The galley equipment and spare parts sales are AB's responsibility while Marine Food Oy is in charge of the installations. The function of Marine Food LLC is primarily to provide US based customers with

⁵³ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 10.

⁵⁴ Ibid.

⁵⁵ The appendix is obtained from Lehtinen, *Overview of a company in marine foodservice industry*.

⁵⁶ Definition of turnkey delivery: When the supplier has the overall responsibility for the delivery of a marine foodservice area.

⁵⁷ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 12-13.

⁵⁸ Ibid., p. 10.

better after sales services. Marine Food group provides its customers with so called turnkey deliveries. According to the group they are one of the few enterprises in the marine foodservice market, which can provide its customers with these kinds of installations without relying on sub-suppliers. The strategy of Marine Food group is to work with long-term relationships, both with shipyards and owners.⁵⁹

3.2.4 Functions, risks and assets within Marine Food group

| Function | Marine Food Oy | Marine Food AB | Marine Food LLC |
|-------------------|-----------------------|-----------------------|------------------------|
| Manufacturing | x | - | - |
| R&D | x | - | - |
| Marketing & Sales | x | x | - |
| Distribution | x | x | - |
| Finance | x | x | x |
| Administration | x | x | x |
| | | | |
| Risks | | | |
| Market risks | x | x | x |
| Currency risks | - | x | - |
| Warehouse risk | x | x | - |
| Warranty risk | x | x | - |
| Credit risk | x | x | x |
| R&D Risk | x | - | - |
| | | | |
| Assets | | | |
| Intangible Assets | x | x | - |
| Tangible Assets | x | x | x |

Figure 3-2 Functions, risks and assets in the Marine Food group

Manufacturing: Marine Food Oy is the only enterprise in the group that holds a manufacturing function which can be attributed to its production of stainless steel (S/S) furniture.

Research and Development (R&D): Marine Food Oy is also responsible for the R&D due to the knowledge of developing sophisticated installation methods.

Marketing: The marketing mostly consist of participating in different fairs worldwide at a few occasions per year. Marine Food Oy and Marine Food AB is equally responsible for this marketing. Furthermore, Marine Food AB has a limited marketing budget to cover ads.

Sales: Each enterprise in the group has its own sales function.

Distribution: Marine Food AB, Marine Food Oy and Marine Food LLC have separate distribution functions.

⁵⁹ Interview with Lehtinen, Teea, October 5, 2009.

Finance: Each company in Marine Food group is responsible for its respective financing. Marine Food AB is however included in Marine Food Oy's agreement with financial institutions and has at the moment less possibilities to influence their position.

Administration: Every company in the group carries their own costs for administration directly.

Market Risks: Each enterprise takes its own market risks. However, normally when the turnkey delivery consist of any kind of galley equipment the Marine Food AB is responsible for the whole contract with the customer since the enterprise has a broader portfolio than Marine Food Oy. Marine Food AB is therefore taking a greater market risk than all the other enterprises.

Currency risks: Marine Food Oy and Marine Food LLC buys and sells in their respective domestic currency, EUR and USD. Marine Food AB does not trade in its domestic currency, SEK, and is therefore exposed to a greater currency risk than Marine Food Oy and Marine Food LLC.

Warehouse risks: The warehouse risks can be allocated to Marine Food AB and Marine Food Oy. Marine Food AB is holding a spare parts stock and equipment stock worth approximately 3, 4 million EUR. Marine Food Oy also holds a warehouse risk due to its stock of S/S that is worth approximately 1 million EUR.

Warranty risks: The warranty risks are held by Marine Food AB and Marine Food Oy based on the scope of supply to the end customer. The warranty time varies from 12 months to 48 months depending on the delivery. There are no warranties for spare parts.

Credit risks: Each enterprise in the group holds its own credit risks. The greatest risk is however taken by Marine Food AB due to the fact that it is often responsible for the turnkey deliveries in cases when galley equipment is involved.

Tangible assets: Each enterprise in the corporate group holds its own tangible assets.

Intangible assets: The intangible assets can be attributed to both Marine Food Oy and Marine Food AB. Marine Food Oy has created and developed the brand name and possesses also a great know-how when it comes to installation systems. Furthermore, Marine Food Oy has a patent on modular galleys. Marine Food AB also holds a great know-how in designing custom-made kitchens for vessels.

3.3 Economic analysis

In an economic analysis it is important to analyze the relevant market and industry. The relevant market at hand for the marine foodservice industry is located in shipyards and shipping companies worldwide. The development and the current situation of the industry will be examined as well as the competition on the market. The competitive advantages of the Marine Food group and the threats will thereafter be analyzed.

3.3.1 Industry

Since 2003 the shipbuilding industry has had a demand growth rate of 33% per year measured in total contracts at shipyards. Due to this increase in new buildings combined with lower rate of scrapping the global freight capacity has a growth rate of 5, 8% in the same period. Additionally, the world fleet will grow with 7, 7% annually if all vessels in the order

book will be delivered in 2009-2012.⁶⁰ The industry growth was engrossed by the strong global economy until mid 2008. This was particularly shown by the ship owner's investing power in new vessels even though many signals warned of tougher times to come. However, in summer of 2008 the growth trend changed due to a number of negative factors, which had an impact on the demand for underlying commodities.⁶¹ The shipbuilding industry is mainly driven by the freight prices and the freight prices are in turn driven by the demand for underlying commodities. The shipbuilders are willing to invest in newbuilding of vessels when the freight prices are high due to prospective revenues. The shipyards therefore invest in new sites to increase the capacity and hence to meet the demand of the shipbuilders. The decrease in the demand for underlying commodities in 2008 lead to pressing down freight prices and in the long run reducing newbuilding contracts. When the orders for the newbuilding vessels are decreasing the shipyards are left with a lot of capacity of building vessels but no contracts. The purchasing power is then in the hands of the shipbuilders which results in reduced prices.⁶² Currently the purchasing power is definitely in the hands of the shipbuilders and shipyards must work hard to attract the business existing. The most attractive qualities in the future will be low prices and quality workmanship.⁶³

Asia is dominant in the shipbuilding market with China in the lead.⁶⁴ The expansion in China has affected both European and Japanese shipyards with higher cost structure when it comes to cost of labour and material. Countries surrounding China such as Vietnam and Singapore have also benefitted from the shipbuilding expansion. The shipbuilding capacity of these countries is approximately half of the European countries. However, with regard to the low-cost status of these countries and the labor intensity within in the industry the above mentioned Asian countries are most likely to pass European shipyards in the future.⁶⁵

Vessel prices are affected by the availability and price of raw material, steel in particular. Approximately 15% of the total cost of building a ship forms around the price of steel. In general, shipbuilding contracts do not contain any index clauses for changes in the prices for raw material. An increase in the raw material price, if not expected and avoided by for example raw material hedging, results in lower margins on old contracts and is compensated by increasing the price of new contracts. The price for steel has decreased with 55% during the last twelve months. This decrease in steel prices allows the shipbuilders to reduce prices at the same time as their profits not necessarily are diminished. The decrease in steel prices is also beneficial for shipbuilders since vessel prices contracted during the economic boom, when the steel was at a record price, can now be built for less.⁶⁶ Shipbuilders can thereby compensate their possible losses as a result of cancellations of newbuildings with lower prices for new contracts.⁶⁷

⁶⁰ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 15.

⁶¹ Ibid., p. 15-16.

⁶² Interview with Lehtinen, Teea, November 11, 2009.

⁶³ Clarkson Research Services Limited, *World Shipyard Monitor*, (2009), Vol 16, No. 10, p. 28.

⁶⁴ Lloyd's register Fairplay, *Shipbuilding market forecast*, (2009) Issue No. 79, p. 9.

⁶⁵ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 24.

⁶⁶ Clarkson Research Services Limited, *World Shipyard Monitor*, p. 28.

⁶⁷ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 25.

It is not easy to estimate how much of the increase in vessel prices that can be allocated to an exchange rate factor since the statistics in new building prices are constantly given in USD. The nominal price of the new buildings would be better reflected if the statistics showed the local currency and were translated into the exchange rate valid on the date of contract signing. The pricing on new buildings is however affected by the exchange rate.⁶⁸

3.3.2 Competition

Marine Food group competes on two sides of the marine foodservice market, both the market for galley equipment and spare parts sales and also the installation market. Due to lack of financial and organizational data available a competitor analysis has been difficult to complete.

3.3.3 Galley equipment and spare parts sales

The competitors on the galley equipment side of the marine foodservice market are many, acting either locally or globally like Marine Food AB. Calculating the market shares has been a very difficult task, which is mostly due to lack of knowledge of the size of the total market. According to the Marine Food group, it is uncertain whether all vessels are potential customers to them and their competitors or not. Another difficulty is to know which competitor who in fact got the order if not Marine Food AB. In the time of writing the thesis no such database is found on the market or within the Marine Food group. The number of competitors in the equipment segment is many. However, a great deal of these competitors are considered to be low quality, and therefore low price, alternatives. This is not a threat when it comes to vessels build in accordance with USPH recommendations since there has to be high quality on the equipment installed. An additional group of competitors in this segment are the local dealers located closely to the harbors that take unit sales from enterprises such as Marine Food AB.⁶⁹

3.3.4 Installation market

Competitors active on the installation market are considerably lower than in the equipment segment. The main competitors are carrying the project leading responsibility just as Marine Food group. Several other enterprises are also working with installation of marine foodservice areas but they do not have the same project leading functions as the main competitors.⁷⁰

3.3.5 Competitive advantage

Marine Food group has an enormous competitive advantage in its *experience in marine project*. Marine Food AB has many years of experience in designing customized kitchens while Marine Food Oy possess great knowledge and experience in creating and designing sophisticated installation systems. This combined experience has turned out to be a successful concept for Marine Food group. It has outrivalled many competitors throughout the years that have tried to break into the market.⁷¹

⁶⁸ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 25-26.

⁶⁹ Interview with Lehtinen, Teea, November 11, 2009.

⁷⁰ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 30.

⁷¹ Interview with Lehtinen, Teea, November 11, 2009.

On the installation market Marine Food group also has a great advantage in being one of the few enterprises carrying out *turnkey deliveries*. Marine Food group is furthermore the only company on the market that is able to handle the total scope of delivery due to the great in-house competence and the fact that it does not have to rely on sub-suppliers.⁷² There are major cost disadvantages for new entrants, which can be attributed to the need for expensive machinery and modern facilities. Product technology and know-how are also factors that are crucial when establishing an installation system. Marine Food Oy has established a close cooperation with a Finnish shipyard and holds therefore a good position on the Finnish market. The technique in developing modular building for galleys and pantries has taken a long time to develop which requires a great know-how. It also put pressure on the capacity and the logistical supply chain. Moreover, the modular galleys are patented which increases the competitive advantage.⁷³ Turnkey deliveries are beneficial for the buyer in many ways. Warranty issues are always easier to handle if there is only one enterprise responsible for the entire delivery.⁷⁴

Marine Food group holds another competitive advantage in *producing its own stainless steel furniture*. The main material of a galley is stainless steel since walls and ceilings are made solely of it. The advantage of having its own production lies in the possibility of buying large quantities. Hence, Marine Food group is less vulnerable for price increases in raw material compared to enterprises that are dependent on other stainless steel producers.⁷⁵

Today, Marine Food group has a larger *after sales* department than any other actor in the marine foodservice market. This fact is a competitive advantage, especially since the economic downturn result in that many ship owners struggle financially. Consequently there will be a greater interest in making the equipment last longer and as a result the restoration works and unit sales including spare parts will increase.⁷⁶

3.3.6 Threats

The geographical location of the *market is shifting* from Europe to Asia since the number of Asian ship owners are on the rise. Consequently, there is an immediate risk of low-price no-brand Asian manufacturers to enter the marine foodservice market.⁷⁷

Marine Food group is a dealer on the market *without own production* when it comes to marine foodservice equipment. The group is therefore more dependent on sub-suppliers compared to its competitors manufacturing the equipment in-house. Since the lapse of time between quotation and delivery can be as long as three or more years many uncertainties come with not manufacturing its own equipment such as price and availability which the manufacturer is not willing to guarantee.⁷⁸

⁷² Interview with Lehtinen, Teea, November 11, 2009.

⁷³ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 32.

⁷⁴ Interview with Lehtinen, Teea, November 11, 2009.

⁷⁵ Lehtinen, *Strategic Overview of a company in marine foodservice industry*, p. 36.

⁷⁶ Ibid., p. 40.

⁷⁷ Ibid., p. 34-35.

⁷⁸ Ibid., p. 35.

3.4 Analysis of the transactions

The analysis of transactions will investigate the transactions between Marine Food Oy, Marine Food AB and Marine Food LLC. Transaction with third parties will also be examined and analyzed.

3.4.1 Transactions within the Marine Food group

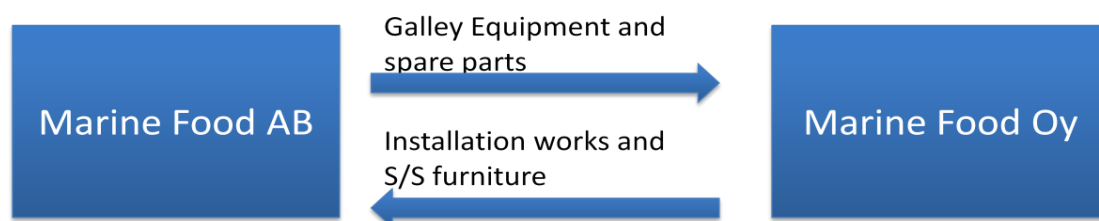


Figure 3-3 Overview of the transactions between Marine Food AB and Marine Food Oy

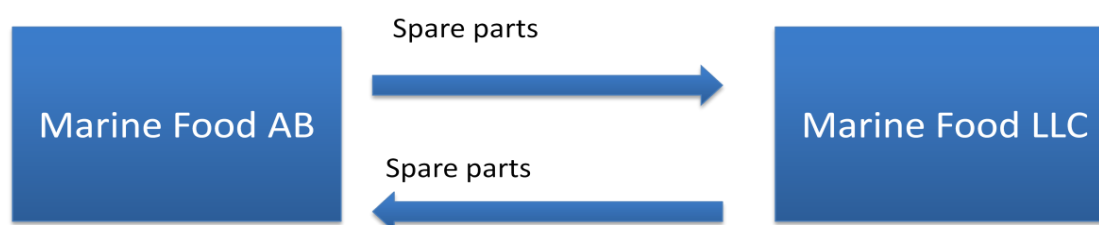


Figure 3-4 Overview of the transactions between Marine Food AB and Marine Food LLC.

The largest volumes are traded between Marine Food AB and Marine Food LLC, which can be mainly assigned to sales of spare parts. Marine Food AB is selling spare parts to Marine Food LLC and the left-over's are sold back to Marine Food AB. All the sales from Marine Food AB to US based customers go through Marine Food LLC that is primarily to provide the customers with better service. Marine Food LLC purchases and resells spare parts from other companies than Marine Food AB as well. These independent suppliers are mostly US-based companies.⁷⁹

Sales between Marine Food AB and Marine Food Oy can vary significantly in volume depending on the scope of supply. Turnkey deliveries are usually offered as one package deal, where one of the group companies is the selling (contracting) party and the other one remains as a supplier. In charge of the turnkey delivery with the overall risks involved is the company that has the relationship and contact with the customer and also has the largest share of the total scope of supply. When Marine Food AB is responsible for a turnkey delivery to the end customer, Marine Food Oy is debiting Marine Food AB for carrying out the design and installation. Marine Food Oy is furthermore selling S/S furniture to Marine Food AB. There are however situations where Marine Food AB only buys the installation works and purchase the S/S furniture from other suppliers.⁸⁰

Contrary, in dealings when Marine Food Oy is responsible for a turnkey delivery, Marine Food AB is selling galley and laundry equipment to Marine Food Oy. Transactions from

⁷⁹ Interview with Lethinen, Teea, October 5, 2009.

⁸⁰ Ibid.

Marine Food AB to Marine Food Oy can also consist of spare parts, which are resold to customers. Marine Food Oy does not purchase galley equipment or spare parts from other companies than Marine Food AB. The different kinds of transactions within the group are not numerous, sales of goods and services being the largest items. Since Company SEA Pte is a new established subsidiary no transactions have yet taken place between that enterprise and the other enterprises in the group.⁸¹

3.4.2 Transactions with third parties

The transactions with third parties can vary a lot depending on the situation. Marine Food group provides turnkey deliveries, sells separate galley equipment, spare parts and performs separate installations to its customers. The S/S furniture, produced by Marine Food Oy, is however not sold separately to third parties but only in connection with turnkey deliveries. The terms of the contracts with third parties are to a wide extent similar. There is however a difference in the credit terms which are longer in the transactions within the Marine Food group. The transactions with third parties also differ in the sense that the galley equipment and installation systems are customized depending on the kind of vessels that are built and the size of galleys. It is therefore vast differences between the many customer segments. The differences can be allocated to the scope of supply, for example merchant ships usually ask for basic equipment whereas cruise vessels demand high capacity and more complex features. The market areas vary a lot due to geographical and cultural factors.⁸²

Galley equipment to third parties is mostly sold to Asia while the sales of spare parts can generally be allocated to Europe. Installation works to third parties are mostly performed in Finland due to the close relationship with a Finnish shipyard developed by Marine Food Oy. 10% of Marine Food group's net turnover consists of controlled transactions, the remaining part is sold to third parties without any involvement from the other group companies.⁸³

3.5 Conclusion

Marine Food Group is an actor in the marine foodservice service market with many years of experience both in the galley equipment segment and in the installation segment of the market. A conclusion that can be drawn from the investigation in this chapter is that the value creating elements within the group are the after sales department and the in-house competence in creating sophisticated installation systems.

The value creating company in the transactions between Marine Food AB and Marine Food LLC is Marine Food AB. It holds a greater deal of the functions, risks and assets and also the competitive advantage which is the after sales department. Marine Food LLC is therefore carrying out the routine profit and is to be considered as the least complex entity.

The transactions between Marine Food AB and Marine Food Oy consist of both goods and services. When it comes to the services provided by Marine Food Oy to Marine Food AB the value creating element in the transaction is the great know-how in creating the installation systems. Furthermore the Marine Food Oy holds more functions, risks and assets than

⁸¹ Interview with Lehtinen, Teea, October 5, 2009.

⁸² Ibid.

⁸³ Ibid.

Marine Food AB why the latter company is considered to be the least complex entity and carries out the routine profit.

Marine Food Oy also sells fully-produced S/S furniture to Marine Food AB. The company, which is considered to be the least complex entity and carrying the routine profit in this transaction, is Marine Food AB. Marine Food Oy holds the manufacturing function and takes the overall risks in producing the S/S furniture.

Marine Food AB sells galley equipment and spare parts to Marine Food Oy. Marine Food AB possess a greater an after sales department than any other competitor on the market. The after sales department located at Marine Food AB is therefore value creating and the functions and risks associated with the after sales department is allocated to Marine Food AB. The least complex entity and the one carrying the routine profit in this transaction is hence Marine Food Oy. When it comes to the galley equipment Marine Food Oy is also considered to be the least complex entity since Marine Food AB takes more important risks and holds more important functions.

4 OECD

4.1 Introduction

This chapter consists of information about the OECD and its recommendations within the area of transfer pricing. In order to develop a transfer pricing system it is important to investigate and analyze the different transfer pricing methods of the OECD that can be used when transferring goods and services. The chapter starts with describing the different reports of the OECD. The recommendations on how to establish transfer prices in accordance with the arm's length principle is thereafter described. The chapter continues with information about the transfer pricing methods including the application of respective method. Since the transactions between Marine Food Oy and Marine Food AB contains of services the OECD's view on intra-group services is therefore examined in the last section of this chapter.

To describe the importance of the OECD within the area of transfer pricing some fundamental background information is necessary. In 1961 the organization was founded and consists currently of 30 member countries.⁸⁴ OECD has aimed to create internationally approved rules which govern the way the Member Countries handle international taxation.⁸⁵ The OECD provides a forum where governments can seek answers to common problems, compare policy experiences and coordinate domestic and international policies. The organization also share and exchange expertise and views with over 100 countries that not are member states of the organization.⁸⁶ The OECD is consequently a powerful organization which influences both its Member Countries and other countries over the world.

4.2 Reports of the OECD

In order to explain and analyze the transfer pricing recommendations established by the OECD, different reports and documents need to be examined. The OECD Model Tax Convention is the most important instrument to achieve a consistent internationally approach to international taxation.⁸⁷ Art. 9 of the Model Tax Convention explains how MNEs should manage transfer pricing issues. The OECD CFA has addressed transfer pricing related issues with respect to MNEs and created several reports on the subject. The first report was developed in 1979,⁸⁸ and dealt with the so-called arm's length principle, set out in Art. 9 in the Model Tax Convention. The next important reports were formed in 1984 and in 1987 and are called *Transfer Pricing and Multinational Enterprises – Three Taxation*

⁸⁴ Information from the website of the OECD.

⁸⁵ OECD documents, Tax aspects of transfer pricing within multinational enterprises: the United States proposed regulations: a report by the Committee on Fiscal Affairs on the proposed regulations under section 482 IRC, (Paris 1993), Executive Summary, para 5.

⁸⁶ Information from the website of the OECD.

⁸⁷ OECD documents, Tax aspects of transfer pricing within multinational enterprises: the United States proposed regulations: a report by the Committee on Fiscal Affairs on the proposed regulations under section 482 IRC, (Paris 1993), Executive Summary, para. 5.

⁸⁸ OECD documents, Transfer pricing and multinational enterprises: report of the OECD Committee on Fiscal Affairs, (Paris 1979).

Issues (1984) respective *Thin Capitalization* (1987). These reports focused on specific problems within the field of transfer pricing.⁸⁹

The organization established in 1995 TPG which were intended to be a revision and collection of the above mentioned reports.⁹⁰ The OECD also issued the TPG for another reason. The organization was concerned that the proposed Regulations of the US would interfere with the coherence on transfer pricing practices that had been developed among the Member countries during several years.⁹¹ A special task force was therefore created by the CFA of the OECD, which created a Report with the purpose of providing the US with other Members countries joint opinion of the proposed Regulations.⁹² The TPG issued in 1995 was thus drawn upon the Report from 1993 with the difference that it was written in a wider range since that Report just examined the US proposed regulations particularly.⁹³

In order to reduce conflicts between tax authorities and MNEs and also among tax authorities in different countries the TPG are meant to assist tax authorities, of both Member countries and non-Member countries, in finding solutions to transfer pricing cases which are acceptable to both parties. The TPG also examine and discuss methods to use when estimating if the conditions of commercial and financial relations are in accordance with the arm's length principle.⁹⁴ The Member countries of the OECD are advised to pursue the TPG when dealing with their national transfer pricing issues. Tax payers are also encouraged to follow the TPG when investigating whether their transfer pricing corresponds with the arm's length principle.⁹⁵

The OECD published in 2009 a Proposed revision of Chapter (Ch.) I-III of the TPG which reflects the outcome of two discussion drafts on comparability and on transactional profit methods released in 2006 respective 2008. The Proposed revision deals in particular with the hierarchy of the transfer pricing methods, comparability analysis and guidance on the application of the transactional profit methods.⁹⁶

4.3 Establishing arm's length prices

The arm's length principle is the international standard that the Member countries of the OECD have agreed should be used by MNEs and tax authorities for tax purposes.⁹⁷ To apply the arm's length principle means that the transactions between related enterprises shall be compared with the transactions between independent enterprises. In order for the situations to be comparable, the possible differences should not materially affect the condition

⁸⁹ TPG, Preface, para. 13.

⁹⁰ Ibid.

⁹¹ OECD documents, Tax aspects of transfer pricing within multinational enterprises: the United States proposed regulations: a report by the Committee on Fiscal Affairs on the proposed regulations under section 482 IRC, (Paris 1993), Executive Summary, para 2.

⁹² Ibid., para. 3.

⁹³ TPG, Preface, para. 14.

⁹⁴ Ibid., para 15.

⁹⁵ Ibid., para 16.

⁹⁶ Proposed revision, p. 2.

⁹⁷ TPG, para. 1.1.

investigated, for example the price. If such differences exist, the situations could nevertheless be comparable if accurate adjustments can be made to erase the result of the differences.⁹⁸ Comparing elements of the transactions that would affect conditions in arm's length dealings, is necessary to determine the degree of the comparability. When the degree of comparability is determined appropriate adjustments can be made in order to comply with the arm's length principle.⁹⁹

The arm's length principle should preferably be applied on a transaction by transaction basis in order to estimate fair market value. Separate transactions are however often strongly connected or constant, which means that separately evaluations can not be made.¹⁰⁰ The TPG give some examples on where it is impractical to establish transfer prices for each transaction. These examples include: 1. *Long-term contracts for the supply of commodities and services*, 2. *Rights to use intangible property*, and 3. *Pricing a range of closely linked products*.¹⁰¹ On the contrary some transactions contracted between related enterprises as a package should be evaluated separately in order to establish transfer prices in accordance with the arm's length principle. MNEs can set a sole transfer price for a number of profits for example patents, know-how, provision of technical and administrative services and not seldom are these type of arrangements referred to as a package deal.¹⁰²

The arm's length principle may in some situations be applied with the result of one single figure that is the most reliable when determining if the conditions of a transaction between related companies are at arm's length or not. The TPG although stress that transfer pricing is not an exact science and many situations will therefore produce a range of figures that are fairly equally reliable.¹⁰³ When the relevant circumstances of a transaction between related enterprises, for example price or margin, are within the arm's length range, adjustment must not be made. However, if the relevant circumstances of the transaction between related enterprises fall outside the arm's length range and if the taxpayer can not argue that the circumstances meet the arm's length principle, adjustments must be made, taking the arm's length range into account. Such adjustments should be made to the point within the arm's length range that best reflect the facts and circumstances of the transaction between related enterprises.¹⁰⁴

The Proposed revision also suggest that adjustments should be made to point in the range which best reflects facts and circumstances of the controlled transaction.¹⁰⁵ Where it is not possible to differentiate between the various points within the range due to that it contains results that are fairly equal and reliable, any point in the range may satisfy the arm's length principle. If this can not be done and comparability defects remain measures of central tendency, for example the median, the mean or weighted averages, may be appropriate to use

⁹⁸ TPG, para. 1.15.

⁹⁹ Ibid., para. 1.17.

¹⁰⁰ Ibid., para. 1.42.

¹⁰¹ Ibid.

¹⁰² Ibid., para. 1.43.

¹⁰³ Ibid., para. 1.45.

¹⁰⁴ Ibid., para. 1.48.

¹⁰⁵ Proposed revision, para. 3.60.

in order to decide the point to which the adjustment should be made.¹⁰⁶ The Proposed revision suggests furthermore that certain uncontrolled transactions should be eliminated if it is possible to determine that the degree of comparability in those uncontrolled transactions is smaller than others.¹⁰⁷ When comparability defects remain that can not be identified and therefore not adjusted, even after every effort to exclude points which have a smaller degree of comparability, statistical tools such as interquartile range or other percentiles, can be used to enhance the reliability of the analysis, if the range is broad.¹⁰⁸

To fully understand the facts and circumstances of the transactions between related enterprises, examining data from the relevant year and prior years may be useful. Information obtained from such an analysis may reveal facts that could have affected the determination of the transfer price.¹⁰⁹ Data from multiple years could also be helpful when presenting information about the important business and product life cycles of the comparables.¹¹⁰

4.4 Transfer pricing methods

The TPG state that there are different methods that can be used in order to make sure that the conditions imposed in commercial or financial relations in a MNE are compatible with the arm's length principle. These methods are set forth in Chapters II and III in the TPG and should be applied depending on the circumstances of each separate case.¹¹¹ Furthermore, MNEs can use other methods than the ones described in the TPG, or combine several methods, provided that appropriate documentation is uphold.¹¹² The TPG also state that applying one method is sufficient to meet the arm's length principle.¹¹³ The transfer pricing methods described in Chapter II are traditional transaction methods. According to the TPG, these methods are preferable to other methods since it is the most direct way to determine whether the transactions within MNE groups are at arm's length.¹¹⁴ However, where no data or no reliable data is available the transfer pricing methods set forth in Chapter III, called "Other methods", can be applied.¹¹⁵

The traditional transaction methods consist of the comparable uncontrolled price method (CUP), the resale price method (RPM) and the cost plus method. These methods are based on data relating to comparable transactions which are on arm's length.¹¹⁶ Chapter III of the Guidelines contains a discussion and guidance for application of other methods than the traditional transaction methods that are in accordance with the arm's length principle.

¹⁰⁶ Proposed revision, para. 3.61.

¹⁰⁷ Ibid., para. 3.55.

¹⁰⁸ Ibid., para. 3.56.

¹⁰⁹ TPG, para. 1.49.

¹¹⁰ Ibid., para. 1.50.

¹¹¹ Ibid., para 1.68.

¹¹² Ibid., para. 1.69.

¹¹³ Ibid., para. 1.68.

¹¹⁴ Ibid., para 2.5 & 2.49.

¹¹⁵ Ibid., para. 2.49.

¹¹⁶ Ibid., para 2.1.

These methods are called transactional profit methods and can be used in situations when the traditional transaction methods can not be applied alone or at all.¹¹⁷ These situations would be considered as last resort.¹¹⁸ When practical difficulties to apply the traditional transaction methods exist, due to complexity of real business life, applying the traditional profit methods might establish a transfer price which is in accordance with the arm's length principle. Difficulty in finding data is however not an acceptable reason to apply the transactional profit methods. The transactional profit methods consist of the profit split method (PSM) and the transactional net margin method (TNMM). According to the TPG the transactional profit methods are based on the profits that arise from a transaction between related enterprises.¹¹⁹ Profit based methods are only accepted if they are coherent with Art. 9 of the OECD Model Tax Convention. To achieve this coherence the transactional profit methods should be applied at an arm's length basis. Profits arising from transactions between related enterprises should therefore be compared to profits arising from comparable transactions between independent enterprises.¹²⁰

Regarding the hierarchy of the transfer pricing methods the OECD has in the Proposed revision addressed that its status of last resort is inaccurate based on the experience obtained in applying these methods. The proposal is that this status shall be removed and replaced with a standard under which the transfer pricing method selected should be the "*most appropriate method to the circumstances of the case*".¹²¹ When finding the most appropriate method the circumstances of the case, strengths and weaknesses of each method should be taken into account. Whether the method is appropriate or not, for the nature of the transaction, should be determined in particular through a functional analysis, the availability of information (especially on uncontrolled comparables) and the degree of comparability including the reliability of adjustments that might be necessary to eliminate differences.¹²² According to the Proposed revision the traditional transaction methods are preferable in cases where profit methods can be applied in an equally reliable manner.¹²³

4.4.1 The comparable uncontrolled price method

According to the TPG the CUP method "*compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances*".¹²⁴ The dealings within a MNE group might not be at arms length if there is a difference between the two prices.¹²⁵

The CUP method can be applied by comparing a controlled transaction with a transaction between one of the parties to the controlled transaction and an independent company,

¹¹⁷ TPG., para. 3.1.

¹¹⁸ Ibid., para. 3.50.

¹¹⁹ Ibid., para. 3.2.

¹²⁰ Ibid., para. 3.3.

¹²¹ Proposed revision, p. 2.

¹²² Ibid., para. 2.1.

¹²³ Ibid., para. 2.2.

¹²⁴ TPG, para. 2.6.

¹²⁵ Ibid.

which is called an Internal CUP.¹²⁶ This method is appropriate to use when the same or a very similar product is sold, an intangible is licensed or a service is provided to a related enterprise as well as to an unrelated enterprise.¹²⁷ An External CUP is another variant, which is when a controlled transaction is compared with a transaction between third parties.¹²⁸ The external CUP provides that reliable information regarding third-party prices, conditions and relevant markets exist.¹²⁹ When applying the arm's length principle the CUP method is the most reliable transfer pricing method, if it is possible to locate comparable uncontrolled transactions. The OECD has therefore given this method the highest priority.¹³⁰ The reliability of CUPs depend on if there are no differences in the transactions being compared or if any differences can be correctly adjusted. In the open market, changing circumstances of a transaction might materially affect the price. Consequently, the efficiency of CUPs depend on the reliability of adjustments made to eliminate differing circumstances of transactions. However, transfer pricing information regarding third parties can sometimes be impossible to identify and the CUP method will therefore not be appropriate to use. Furthermore, differences in transaction terms or market cycle can not often be adjusted and the CUP method will not provide a reasonable basis for comparing transactions.¹³¹

4.4.2 The cost plus method

The cost plus method starts with the total costs of the original supplier in a transaction between related companies for property transferred to a related purchaser. An appropriate mark-up is then added to these costs to compensate the supplier for functions performed and the market conditions. The arm's length price is established in the transaction between the related companies after the mark up has been added to the costs.¹³²

The cost plus mark up of the supplier in the transaction between related enterprises should be set with guidance from the cost plus mark up deriving from transactions between unrelated enterprises with the same supplier. Reference can also be given to the cost plus mark up that would have occurred in transactions between unrelated enterprises.¹³³ Comparing transactions are as mentioned above vital. However, fewer adjustments are required for product differences compared to the CUP method. Differences in other attributes such as functions performed, risks assumed and assets used that affect the cost plus mark ups should be adjusted to account for such differences.¹³⁴

¹²⁶ Adams, Graham, *Transfer Pricing: A UK perspective*, p. 12.

¹²⁷ Information from IBFD Database, please see under General, Introduction to transfer pricing, Selection of methods, Application of methods, CUP method.

¹²⁸ Adams, Graham, *Transfer Pricing: A UK perspective*, p. 12.

¹²⁹ Information from IBFD Database, please see under General, Introduction to transfer pricing, Selection of methods, Application of methods, CUP method.

¹³⁰ TPG, para. 2.7.

¹³¹ Adams, Graham, *Transfer Pricing: A UK perspective*, p. 13.

¹³² TPG, para. 2.32.

¹³³ Ibid., para. 2.33.

¹³⁴ Ibid., para. 2.34.

Determining costs can cause some difficulties when applying the cost plus method.¹³⁵ For example, a supplier in the transaction between related enterprises may own its business assets while the supplier to which reference is made applying the cost plus method employs leased business assets. It is therefore important to apply a comparable mark up to a comparable cost basis when using the cost plus method.¹³⁶ Enterprises may also use different basis for reporting their costs. In order to achieve consistency the differences must be identified and analyzed so that appropriate adjustments can be made.¹³⁷ Hence, it is of great importance to make an evident definition of the cost base concerned in order to make a reliable comparison with unrelated enterprises. The costs that can be included in the cost base are direct cost of product or service and indirect cost of production.¹³⁸

The cost plus method is mostly applied to manufacturers in a controlled transaction in cases where CUPs are not available and the manufacturer is the least complex entity in the transaction.¹³⁹ Where a cost basis is inconsistent when applying the cost plus method the TNMM may be preferable due to that direct and indirect costs of production and operating expenses not have to be differentiated under that method.¹⁴⁰

4.4.3 The resale price method

The base of the RPM is the price at which a product, that has been initially purchased from a related enterprise, is resold to an independent enterprise. This price, the resale price, is then reduced by an appropriate gross margin called the resale price margin. The resale price stands for the income a reseller in an open market would seek to cover its costs related to the sale and making an appropriate profit. Risks assumed, functions performed and assets used are taken into account in the resale price. The arm's length price between the related parties is the price left after subtraction of the resale price margin and adjustment for other costs linked to the purchase of the product.¹⁴¹

The resale price margin may be determined with guidance from the resale price margin the same reseller earns on products purchased and sold in comparable uncontrolled transactions. Guidance may also be derived from resale price margins made by independent enterprises in comparable uncontrolled transactions.¹⁴² When making comparisons for the purposes of the RPM product differences are less significant than under the CUP method. The reason is that profit margins are less likely to be affected by product differences than the price.¹⁴³ Even though the RPM allows greater product differences, the property transferred in the transaction between related parties must still be compared to property being trans-

¹³⁵ TPG., para. 2.36.

¹³⁶ Ibid., para. 2.37.

¹³⁷ TPG, para. 2.39 & Adams, Graham, *Transfer Pricing: A UK perspective*, p. 15.

¹³⁸ TPG, para. 2.40.

¹³⁹ Information from IBFD Database, please see under General, Introduction to transfer pricing, Selection of methods, Application of methods, cost-plus method.

¹⁴⁰ Ibid.

¹⁴¹ TPG, para. 2.14.

¹⁴² Ibid., para 2.15.

¹⁴³ Ibid., para. 2.16.

ferred in a transaction between unrelated enterprises. Closer comparability of property will however provide a better result.¹⁴⁴ Other elements such as functions performed, assets used and risks assumed are more essential when applying the RPM. These kinds of elements have an equal effect on the resale price margin as they have on the price under the CUP method. Material differences affecting the gross margins earned in transactions between related enterprises and in transactions between unrelated enterprises, should be adjusted.¹⁴⁵ The comparability will be most accurate when a short time passes between the reseller acquiring and reselling the goods since it is less likely that certain factors for example change in the market will have to be considered in the comparison.¹⁴⁶ Furthermore, the resale price margin will be influenced by the reseller's level of activity. The level of activity has a wide range, from situations where the reseller acts like a forwarding agent to situations when the reseller take the overall responsibility for the risks involved. The resale price margin could hence be a small one in the controlled transactions if the reseller does not perform significant activity but merely transfer goods to third parties.¹⁴⁷ In situations where the reseller obviously performs important commercial activity besides the resale activity, a reasonable price margin might then be anticipated. Hence, if the reseller holds valuable intangibles and uses it in its activity, such as marketing organization, the arm's length price may be inappropriate to set with reference to uncontrolled reseller that does not hold similar valuable intangibles.¹⁴⁸ The resale price margin can also be affected depending on if the reseller has the exclusive right to sell the goods and this type of arrangements should be taken into account in comparisons.¹⁴⁹ The RPM is most effective in cases where the reseller do not add high value to the property transferred, for example by adding special features to the product.¹⁵⁰ It is therefore appropriate to apply the RPM when the reseller is the "least complex entity".¹⁵¹

4.4.4 The profit split method

Transactions that are very interrelated can sometimes not be evaluated separately.¹⁵² The PSM analyzes the profits from a transaction between related enterprises and split those profits based on the contribution of each enterprise. The split of the profits must be compatible with what have occurred in a transaction between independent enterprises. The contribution of each enterprise is determined by a functional analysis which is valued with regard to reliable external market data, if such is available. Reliable external data could be

¹⁴⁴ TPG., para. 2.18.

¹⁴⁵ Ibid., para. 2.21.

¹⁴⁶ Ibid., para. 2.23.

¹⁴⁷ Ibid., para. 2.24.

¹⁴⁸ Ibid., para. 2.25.

¹⁴⁹ Ibid., para. 2.27.

¹⁵⁰ Adams, Graham, *Transfer Pricing: A UK Perspective*, p. 13 & Information from the IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of Methods/Search for comparables, Application of methods, Resale price method.

¹⁵¹ Information from the IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of Methods/Search for comparables, Application of methods, Resale price method.

¹⁵² TPG., para 3.5.

found in transactions between independent enterprises with comparable functions.¹⁵³ When related enterprises use the PSM they should seek to divide the profits that independent enterprises would have expected to gain in a joint venture relationship. The profits, on which the conditions are established upon, would have to be estimated since it is not likely for the taxpayer to know the exact profits of the business activity when the conditions are established.¹⁵⁴ The PSM is appropriate to use when both related companies use valuable intangibles.¹⁵⁵

The TPG discuss two ways of estimating the division of profits. The first approach discussed is the contribution analysis under which the total profits from the transaction between the related enterprises are divided between those enterprises. The functions performed by the related enterprises participating in the transaction are the value on which the allocation of the profits is based upon. In addition, external market data that shows how independent enterprises would have divided profits in comparable situations shall be taken into consideration.¹⁵⁶ Often the approach will have to be determined on a case-to-case basis since it can be difficult to determine the contribution of each related enterprise involved in the transaction. The nature and degree of each enterprise's contribution of contradictory types can be compared and a percentage assigned, which is based on the comparison and external data.¹⁵⁷ The contribution analysis is rarely used due to lack of external data.¹⁵⁸

The second approach discussed is the residual analysis, which divides the profits from the transactions between related enterprises in two steps. In the first step adequate profit is assigned to each participant. The profit is adequate when it provides a basic return for the type of transactions in which the participant is engaged. The basic return would generally be decided with reference to the market returns realized by independent enterprises in similar kinds of transactions. The basic return would therefore normally not comprise the return that would be created due to any valuable assets held by the participants. In the second step the remaining residual profit (or loss) would be divided between the related enterprises by considering facts and circumstances that show how independent enterprises would have divided the residual profit.¹⁵⁹

An advantage with the PSM is that it does not rely a great deal on close comparable transactions and can therefore be used in situations where no transactions between independent enterprises can be identified.¹⁶⁰ The PSM is also advantageous in the sense that profit is not likely to be divided in a way that leave enterprises in a extreme or improbable profit position.¹⁶¹ The PSM also has weaknesses. It is less reliable than the traditional transaction me-

¹⁵³ Ibid.

¹⁵⁴ TPG, para. 3.11.

¹⁵⁵ Information from the IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of Methods/Search for comparables, Application of methods, Profit split.

¹⁵⁶ TPG, para. 3.16.

¹⁵⁷ Ibid., para. 3.18.

¹⁵⁸ Information from the IBFD Database, please see under General, Introduction to Transfer Pricing, Selection of Methods/Search for comparables, Application of methods, Profit split.

¹⁵⁹ TPG, para. 3.19.

¹⁶⁰ Ibid., para. 3.6.

¹⁶¹ Ibid., para. 3.7.

thods since the transfer price is established by a more indirect way of comparing transactions.¹⁶²

4.4.5 The transactional net margin method

The TNMM examines the net profit from transactions between related enterprises as a percentage of an appropriate base for example sales, costs, assets. In order for the application of the TNMM to be reliable the net margin should be established by reference to net margins earned by the same taxpayer in transactions with independent enterprises. If such references are not possible, guidance can be taken from comparable transactions between independent enterprises. A functional analysis is required to determine the comparability between the related and the independent enterprises. Where differences exist between the compared transactions adjustments have to be made to obtain reliable results.¹⁶³ Even though the comparison of the net profit margin under the TNMM is less dependent on product, function and risk similarity than under the traditional transactions methods, there are other factors that can significantly affect net margins.¹⁶⁴ Such factors that could directly affect the net margins are for example competitive position, varying cost structures, differences in the cost of capital.¹⁶⁵

When making an analysis under the TNMM it is solely the profits of the related enterprises associated with the specific transaction that should be considered.¹⁶⁶ The least complex of the related enterprises involved in the transaction should be the tested party in the comparison with independent enterprises. The related enterprise that is the least complex party shall not own valuable intangible property or unique assets.¹⁶⁷ Under the TNMM multiple year data should be considered for both the enterprise and independent enterprises, in order to explain short term economic factors.¹⁶⁸ Furthermore, under the TNMM it is of great importance to consider a range of results since it allow results that would arise in different kinds of commercial and financial conditions.¹⁶⁹

The TNMM has a practical advantage in focusing on only one of the related enterprises when making comparisons of the functions performed and risks assumed with independent enterprises.¹⁷⁰ Another strength with the method is that net margins such as operating income to sales, return on assets or other measures of net profit are less vulnerable to transactional and functional differences in comparing transactions, than are the price studied in the CUP method and the gross margin studied in the RPM. When differences in functions exist it is often shown in deviations in operating expenses. This means that the gross profit margins may vary between enterprises but the might still earn roughly comparable levels of

¹⁶² Adams, Graham, *Transfer Pricing: A UK perspective*, p. 18.

¹⁶³ TPG, para. 3.26.

¹⁶⁴ *Ibid.*, para. 3.34.

¹⁶⁵ *Ibid.*, para. 3.36.

¹⁶⁶ *Ibid.*, para. 3.42.

¹⁶⁷ *Ibid.*, para. 3.43.

¹⁶⁸ *Ibid.*, para. 3.44.

¹⁶⁹ *Ibid.*, para. 3.45.

¹⁷⁰ *Ibid.*, para. 3.28.

net profits.¹⁷¹ The TNMM can furthermore be used as “checking method” for resale and cost plus methods as well as inexact CUP.¹⁷² The greatest disadvantage with the TNMM is that net margins of taxpayers can be affected by elements that do not have a direct effect on gross margins or price. Determining reliable arm’s length net margins can consequently be complicated.¹⁷³ The TNMM is as previously stated based on a one-side analysis since only one of the related enterprises is examined. The one-side analysis is not only an advantage but also a disadvantage since factors unrelated to transfer prices might affect the net margin which can make the TNMM less reliable. A one-side analysis can ascribe a level profit to one enterprise of an MNE group which ends up in leaving other enterprises of the group with questionably low or high levels of profit.¹⁷⁴

4.5 Intra-group services

Intra-group services can consist of different types of services, such as administrative, technical, financial and commercial services. The cost of providing services may be carried by the parent company, by another group member or by a specially selected group (“a group service centre”). Intra-group services consist often of services that typically can be offered externally from independent enterprises besides the services that are ordinarily performed internally.¹⁷⁵ Arrangements for providing intra-group services are sometimes connected with arrangements for transferring goods or intangible property. In these kinds of situations it can be complicated to draw a line between the transfer of property and the transfer of services. Thus, it may be appropriate to consider the principles of aggregation and segregation described in Chapter I of the TPG when transfers both consist of services and property.¹⁷⁶ According to the TPG there are two main issues when analyzing transfer pricing for intra-group services. One issue is to determine if intra-group services in fact have been provided or not. Another issue is what the charge for the intra-group services should be in order to correspond with the arm’s length principle.¹⁷⁷

An intra-group service has been rendered when an activity is carried out for one or more group members by another group member and that activity provides respective group member with economic or commercial value to improve its commercial position. If an independent enterprise not would have been willing to pay or perform such an activity, it should generally not be considered as an intra-group service under the arm’s length principle.¹⁷⁸ This type of analysis depends on the facts and circumstances of each case. Describing a category of activities that are considered to render intra-group services or not is impossible.¹⁷⁹ An intra-group service could be carried out by one member of an MNE in order

¹⁷¹ TPG, para. 3.27.

¹⁷² Hamaekers, Advanced course in Transfer Pricing in Stockholm November (2009), Institutet för utländsk rätt, slide 67.

¹⁷³ TPG, para. 3.29.

¹⁷⁴ Ibid., para. 3.31.

¹⁷⁵ Ibid., para. 7.2.

¹⁷⁶ Ibid., para. 7.3.

¹⁷⁷ Ibid., para. 7.5.

¹⁷⁸ Ibid., para. 7.6.

¹⁷⁹ Ibid., para. 7.7.

to meet a specific need of one or more members of the group and in such cases it is rather uncomplicated to decide whether an intra-group service has been rendered or not. An independent enterprise would normally in comparable conditions satisfy such an identified need either by letting a third party perform the activity or by performing the activity in-house. Consequently, an intra-group service would in such a case be found to exist.¹⁸⁰

When it has been determined that an intra-group service exists, it is necessary to determine if the amount charged corresponds with the arm's length principle. Hence, the intra-group services should be charged in the way that would have been made between independent enterprises in comparable circumstances.¹⁸¹ When a MNE uses a direct-charge method, which means that the related enterprises are charged for specific services, the arrangements established for charge the intra-group services can without difficulty be identified.¹⁸² This kind of direct charging should MNEs be able to implement when similar services also are provided to independent enterprises. When specific services not only are provided to related enterprises but also to independent enterprises in a comparable way and as an important part of the business, MNEs could be assumed to have the ability to express a separate basis for the charge. Consequently, MNEs are in such cases encouraged to establish a direct-charge method in relation to their transaction with related enterprises with the exception of certain cases when it's not appropriate, for example when the services to independent enterprises are occasional or marginal.¹⁸³

However, in some cases it may be necessary to use an indirect charge method due to the nature of the service being rendered. An example on when such an indirect charge method can be applied is when the share of the value of the services provided can not be quantified except on an estimated basis. This issue may be at hand when, for example, sales promotion activities that are handled centrally may affect the amount of goods manufactured or sold by several of the related enterprises.¹⁸⁴

The allocation method chosen must give a result that meets the arm's length principle which means that it should be consistent with what comparable independent enterprises would have been willing to accept.¹⁸⁵ The allocation might be based on different elements, such as turnover, staff employ or some other basis. The appropriateness of the allocation method depends on the nature and usage of the service.¹⁸⁶

When determining the arm's length price for intra-group services, the matter should be considered from two perspectives. Both the service providers' and the recipients' perspective should be taken into consideration. The transfer pricing method that should be used when determining arm's length prices for intra-group services should be made according to Chapters I, II and III of the TPG. Applying the TPG often leads to that the CUP or cost plus method will be applied when pricing transfers of intra-group services. Where a compa-

¹⁸⁰ TPG, para. 7.8.

¹⁸¹ Ibid., para. 7.19.

¹⁸² Ibid., para. 7.20.

¹⁸³ Ibid., para. 7.21.

¹⁸⁴ Ibid., para. 7.24.

¹⁸⁵ Ibid., para. 7.24.

¹⁸⁶ Ibid., para. 7.25.

able service in the recipient's market has been provided between independent enterprises or by the related enterprise rendering the services to an independent enterprise in comparable conditions, a CUP method is most likely to be used. In the absence of a CUP, a cost plus method would likely be proper to use if the type of the activities, assets used and risks assumed are comparable to those of independent enterprises. When it is difficult to apply the CUP and or the cost plus method the transactional profit methods might have to be applied as a last resort.¹⁸⁷

¹⁸⁷ TPG., para. 7.31.

5 Swedish Transfer Pricing Rules

5.1 Introduction

In order to establish a transfer pricing system that is acceptable to the Swedish tax authority and fulfill the purpose of this thesis, it is important to study the Swedish rules applicable on transfer pricing. This chapter will include the current transfer pricing rules followed by an investigation on how the rules correspond to the OECD TPG. Conditions regarding goods and services are only investigated since the transactions involving Marine Food AB consist of goods and services.

5.2 Transfer Pricing Rules

Sweden has provisions against distribution of profits from a Swedish company to its foreign related enterprise/s, which can be found in Section (Sec) 19 and 20 of Chapter (Ch.) 14 of the Income Tax Act (IL). The provision in Ch. 14 Sec. 19 IL is in accordance with the arm's length principle laid down in art 9 of the OECD Model Tax Convention and states that:

“If the income of a person (including a company) who carries on a business is reduced as a result of an agreement to terms which deviate from what would have been agreed between independent businessmen, the income must be computed as if those deviating terms had not existed, provided that

- The person to whom the income is transferred is not subject to tax in Sweden in respect thereof;*
- there are reasonable grounds to assume that an economic relationship exists between the businessman and the person with whom the agreement was made; and*
- the circumstances do not suggest that the deviating terms have been agreed to for reasons other than the economic relationship”.*

The purpose of the provision is to correct too low reported earnings in Sweden due to incorrect pricing in transactions with foreign related enterprises. The provision is furthermore intended to protect the Swedish tax base.¹⁸⁸ It is a special provision for international relations, which is superior to the general tax rules when calculating the result of business operations.¹⁸⁹

In order for the provision to be applied an economic relationship has to exist between the related enterprises. According to Ch. 14, Sec. 20 IL, an economic relationship exist if the taxpayer, directly or indirectly, participates in the management or supervision of the enterprise of the other person or owns part of the capital of such an enterprise, or if the same persons, directly or indirectly, participate in the management or supervision of both enterprises or own part of the capital of both enterprises. An economic relationship is likely to exist when there is a link between the economic relationship and the incorrect pricing.¹⁹⁰

¹⁸⁸ Pelin, Lars, *Internationell Skatterätt i ett svenskt perspektiv*, 4th edn, (Lund, Prospe Design och Grafik, 2004), p. 129.

¹⁸⁹ RÅ 2004 ref. 13.

¹⁹⁰ Rabe, Gunnar, Melbi, Ingrid, *Det svenska skattesystemet*, 21st edn, (Vällingby, Norstedts Juridik, 2008), p. 463.

The provision in Ch. 14 Sec 19 IL states that the price deviation shall derive from an agreement which means that it is to be applied when a contractual relationship exist. Regardless of its nature, any type of transaction could therefore be tested under the provision since a joint transaction must be based on a legally valid contract. Hence, the provision may be applicable on sale or lease of goods, performance of services or interest on loans.¹⁹¹ According to case law, the provision can however not be applied on thin capitalization.¹⁹²

When the transfer price deviates from the arm's length principle, adjustment shall not always be made. The deviation could be motivated by something else than an economic relationship. When enterprises introduce a product into a new market a price deviation may be justified. Incorrect pricing can also occur when a product must be sold at a lower price in one market than in another due to competition and that is another example of when income adjustment according to the provision should not be made.¹⁹³

The Swedish Supreme Administrative Court has also stated that an amendment according to Ch. 14 Sec. 19 IL shall not always be made even though a deviation from the arm's length principle is at hand. Different business aspects need to be considered before an amendment can be motivated. An overall judgment of the transactions between the Swedish and the foreign related enterprises is therefore necessary in many cases. In such overall judgment regard shall be given to other transactions that have compensated, or could be regarded as compensating, for the decrease of income which can be derived to the price deviation. The effect of an overall judgment can be that an amendment shall not be done despite a clear price deviation.¹⁹⁴ The Supreme Administrative Court ruled in the same case that comparisons with hypothetical transactions, when establishing an arm's length price, should be rejected.¹⁹⁵

Transactions concerning goods have been tried to a limited extent by Swedish courts. The most important case is RÅ 1991 ref. 107 which has been discussed above. When it comes to services, Swedish tax law does not contain any guidance on how to define a service or how intra-group services should be treated. Neither is the case law within the area exhaustive. The Supreme Administrative Court has however stated, in a case regarding services, that a standard method can not generally be applied. Whether a transaction deviates from the arm's length principle or not should be determined with regard to the circumstances in the specific case.¹⁹⁶

5.3 Swedish Transfer Pricing Rules in relation to the OECD TPG

Sweden is a member of OECD and reference to the OECD TPG is made both in preparatory work and case law. In preparatory work to the legislation regarding transfer pricing do-

¹⁹¹ Information from the IBFD Database, please see under Country analyses, Sweden, Allocation of Income, Scope of legislation.

¹⁹² RÅ 1990 ref. 34.

¹⁹³ Prop. 1982/83:73, p. 10.

¹⁹⁴ RÅ 1991 ref. 107.

¹⁹⁵ Ibid.

¹⁹⁶ RÅ 1984 1:83.

cumentation reference is made to the transfer pricing methods of the OECD.¹⁹⁷ The Swedish tax authority also has published material that advocates the transfer pricing methods of the OECD. The published material consists both of a report¹⁹⁸ regarding transfer pricing and also guidance regarding international taxation¹⁹⁹. The methods mentioned in the report was at that time the comparable uncontrolled price method, the cost plus method, the resale price method and a fourth method.²⁰⁰ In the same report the Swedish tax authority also stated, that the reports of the OECD are a development towards harmonization and should therefore be indicative and normative when managing transfer pricing issues.²⁰¹ The guidance for international taxation refers to the transfer pricing methods in the OECD TPG and explains its application.²⁰²

Swedish case law utters that even though the OECD TPG are not binding for the Swedish tax authorities, they give a sound and balanced view of the problems with transfer pricing. The guidelines can consequently serve as guidance when applying the provision set out in Ch. 14 Sec. 19 IL.²⁰³

The guidance on how to establish transfer prices in accordance with the arm's length principle is sparse both in Swedish constitutional rules, preparatory work and case law. The OECD TPG and the transfer pricing reports issued by the OECD CFA is therefore of great importance in Swedish tax law.

¹⁹⁷ Prop. 2005/06:169, p. 106.

¹⁹⁸ Skatteförvaltningen, *Internprissättning*, RSV Rapport 1990:1.

¹⁹⁹ Skatteverket, *Handledning för internationell beskattning 2009*, SKV 352.

²⁰⁰ Skatteförvaltningen, *Internprissättning*, RSV Rapport 1990:1, p. 61.

²⁰¹ *Ibid.*, p. 66-67.

²⁰² Skatteverket, *Handledning för internationell beskattning 2009*, SKV 352, p. 262 - 271.

²⁰³ RÅ 1991 ref. 107.

6 Finnish Transfer Pricing Rules

6.1 Introduction

This thesis involves an enterprise established in Finland why it is of great importance to examine the Finnish transfer pricing rules. Studying these rules is necessary to be able to recommend a transfer pricing system that is satisfactory to the Finnish tax authority and hence to meet the purpose of this thesis. This chapter will include the current transfer pricing rules followed by an investigation on how the rules correspond to the OECD TPG. The transactions concerning Marine Food Oy consist of goods and services why consideration only will be given these kinds of transactions.

6.2 Transfer Pricing Rules

Art. 31 of the Act on Tax Assessment Procedure (VML) is a provision which corresponds to the arm's length principle. The provision states that:

“In case a taxpayer and a related party have agreed upon or assigned terms in a business transaction that differ from those that would have been agreed between unrelated parties and the taxable income from the taxpayer's business or other operations has fallen below or the deductible loss has increased compared to the amount that it would otherwise have been, an amount shall be added to the taxable income that would have accrued had the terms followed the terms that would have been agreed between independent parties”.

The provision is applicable on business transactions which mean that the provision not only covers not the regular sales, purchases and services transactions but also financial transactions, transactions regarding intangible property and other arrangements constituted with or without compensation.²⁰⁴ However, the provision does not cover thin capitalization. Art. 31 of the VML is a special provision for tax purposes that has precedence over general tax rules.²⁰⁵

The provision is only applied to related parties. The definition of related parties is laid down in paragraph 2 of Art. 31 of the VML. Related parties are according to the provision, cases where one party has control over the other party. Parties can also be considered to be related when a third party alone or with its inner circle has control over both parties of the transaction.²⁰⁶ A party is considered to have control over another party when:

1. *it directly or indirectly owns the majority of the other party's capital*
2. *it directly or indirectly owns the majority of the voting power of the other party*
3. *it directly or indirectly has the power to nominate the majority of the board of directors or other similar organ of the other party or an organ that has this power; or*
4. *it is jointly managed with another party or it can otherwise actually control the other party.*²⁰⁷

²⁰⁴ HE 107/2006 vp, p. 21.

²⁰⁵ Information from the IBFD Database, please see under Country Analyses, Finland, Allocation of income, Scope of legislation.

²⁰⁶ VML, Art. 31, para 2.

²⁰⁷ Ibid.

The term inner circle refers to spouses or persons living together in a relationship equal to marriage, siblings, half siblings, ascending or descending relatives and their spouses. A natural person may also be the party who has control over both related parties.²⁰⁸ Related parties can consequently not only be enterprises which belong to the same MNE, but also enterprises owned by the same family which do not belong to the same MNE.²⁰⁹

Another provision in Finnish tax law is a general anti-avoidance rule in Art. 28 of the VML. This provision also reflects the arm's length principle and can be applied in cases where price has been set or other action has been taken with the intention of avoiding tax.²¹⁰ If a transfer price is made for the purpose of avoiding tax this provision could be applied together with the provision in Sec. 31 of VML.²¹¹ Consequently, it is possible with such an application to tax profits that can not be covered by solely applying Sec 31 of VML.²¹²

Finnish case law does not contain many rulings on transactions involving goods. Services are not defined in Finnish tax law or in material published by tax authorities. Management/services fees have traditionally been subject to inspection in tax audits. Hence, the case law on services fees is rather extensive but not published.²¹³

6.3 Finnish Transfer Pricing Rules in relation to the OECD TPG

The arm's length principle and how to establish transfer prices in accordance with it is only described to a limited extent in preparatory work and guiding case law within the area is deficient. Since Finland is a member state of the OECD the TPG are of great importance when interpreting the arm's length principle. Preparatory work²¹⁴ to the Finnish transfer pricing legislation bring up the OECD TPG when discussing how enterprises should confirm that their transfer pricing is in accordance with the arm's length principle. The preparatory work also states that the transfer pricing methods and its applications described in the OECD TPG should be followed when selecting transfer pricing method.²¹⁵ Published guidance by the Finnish tax authority also refers to the OECD TPG when dealing with transfer pricing issues.²¹⁶ In the published guidance the Finnish tax authority also stress that the transfer pricing methods set forth in the OECD TPG should be applied.²¹⁷

²⁰⁸ HE 107/2006 vp, p. 22.

²⁰⁹ Information from the IBFD Database, please see under Contry analyses, Finland, Allocation of Income, Concepts of "associated enterprises" and "control".

²¹⁰ Information from the IBFD Database, please see under Country Analyses, Finland, Allocation of Income, Legal basis of arm's length principle.

²¹¹ Helminen, Marjaana, *Finnish International TAXation*, 2nd edn, (Vaanta, Dark Oy, 2005), p. 149.

²¹² Ibid.

²¹³ Information from the IBFD Database, please see under Country Analyses, Finland, Specific Transactions, Definition of services.

²¹⁴ HE 107/2006 vp.

²¹⁵ Ibid., p. 19.

²¹⁶ Vero Skatt, *Dokumentation av internprissättning*, Dnr 1471/37/2007.

²¹⁷ Ibid., p. 38.

Hence, the transfer pricing methods that should be used in Finland are the comparable uncontrolled price method, the cost-plus method, the resale price method, the transactional net margin method and the profit split method. Furthermore, following the OECD TPG when selecting transfer pricing method means that the hierarchy of the methods set out in the TPG should be pursued. Thus, the traditional methods have preference over the profit-based methods.²¹⁸

The Finnish tax authorities have generally accepted when enterprises uses the transactional net margin method. The status of this method can therefore be considered stronger than just a method of last resort.²¹⁹

²¹⁸ Vero Skatt, *Dokumentation av internprissättning*, Dnr 1471/37/2007, p. 38.

²¹⁹ Information from the IBFD Database, please see under Country Analyses, Finland, Transfer Pricing Methods, How to select a method (law and practice).

7 US Transfer Pricing Rules

7.1 Introduction

This chapter includes information about the US transfer pricing rules. It is important to examine these rules in order to develop a transfer pricing system that is satisfactory to the tax authority of the US and thereby fulfill the purpose of this thesis. The relevant transfer pricing rules will be examined as well as the different transfer pricing methods. The transactions concerning the US based Marine Food LLC involve goods, with conditions regarding goods only will be examined.

7.2 Transfer Pricing Rules

The transfer pricing rules of the US are currently regulated in Code Sec. 482 of the Internal Revenue Code (IRC) with the purpose of preventing related enterprises to avoid taxation and equalize a controlled taxpayer with an uncontrolled taxpayer.²²⁰ The Code Sec. 482 states:

“In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits or allowances between or among such organizations, trades or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations, trades or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936 (b)(3) (B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.”

The section is solely accessible to the fiscal authorities and may not be invoked by the taxpayer.²²¹ The scope of the section is broad. It can be applied both to domestic and international transactions and does not require any discovery that the involved parties are avoiding tax on purpose.²²² Since the scope of the section is very broad, detailed Regulations have been issued under the section.²²³

The section covers cases where two or more taxpayers that are owned or controlled directly or indirectly by the same interests. The term “controlled” is not further defined in the Code but an interpretation and definition is laid down in the Regulations. The interpretation of the term is quite broad and states that it is the realities of the situation that are decisive, not the form or the mode of exercise.²²⁴ Courts have addressed that the wording of Code Sec. 482 is broad and sweeping. Its application depends on locating either ownership or control,

²²⁰ Levey, Wrappe, *Transfer Pricing: Rules, Compliance and Controversy*, p. 4.

²²¹ McDaniel, Paul, Ault, Hugh, Repetti, James, *Introduction to United States International Taxation*, 5th edn, (The Hague, Kluwer Law International, 2005), p. 146.

²²² *Ibid.*, p. 145.

²²³ *Ibid.*

²²⁴ US Regs., 1.482 – 1 (i) (4).

which allows the Internal Revenue Service (IRS) to make a broad interpretation of the Code Sec. 482.²²⁵

The Code Sec. 482 reflects the globally accepted arm's length principle which is referred to as the arm's length standard. The arm's length standard is according to the Regulations met if the results of a controlled transaction are consistent with the results that would have been reached if uncontrolled taxpayers had been involved in the same transaction under the same circumstances.²²⁶ The arm's length result must be decided under the transfer pricing method that, with regard to the facts and circumstances, presents the most reliable degree of an arm's length result.²²⁷ The taxpayer is consequently expected to choose the "best method" to establish arm's length results. A hierarchy of the different methods does not exist and no method is regarded to be more reliable than others. The taxpayer does not have to choose the best method based on the inapplicability of another method. However, if another method is later shown to be the best method, that method must be used.²²⁸

When determining the best method the degree of comparability between the related party examined and an uncontrolled transaction, the quality of the data and assumptions are two essential factors that need to be considered.²²⁹ The reliability of a chosen transfer pricing method depends on the comparability between the uncontrolled transaction and the controlled transaction, considering the comparability factors and after adjusting material differences.²³⁰ According to the Regulations, each method requires an analysis of the factors that have an affect on the comparability under that method. The factors that should be examined are functions, contractual terms, risks, economic conditions and property or services.²³¹

The too low transfer price between related enterprises may be justified if the taxpayers seek to enter into new markets or to increase a product's share of an existing market. The taxpayer must however show that an uncontrolled taxpayer had used such a strategy under similar circumstances under an equal time period.²³²

According to the Regulations, applying a transfer pricing method may not solely produce a single but a number of arm's length prices that achieve the same level of comparability.²³³ Hence, the taxpayer is allowed to set up a range of results received in applying the selected method to two or more comparable uncontrolled transactions.²³⁴ This arm's length range will be based on the uncontrolled comparables that have, or will have through adjustments,

²²⁵ Levey, Wrappe, *Transfer Pricing: Rules, Compliance and Controversy*, p. 7.

²²⁶ US Regs., 1.482 – 1 (b) (1).

²²⁷ Ibid., 1.482 – 1 (c) (1).

²²⁸ Ibid.

²²⁹ Ibid., 1.482 – 1 (c) (2).

²³⁰ Ibid., 1.482 – 1 (d) (2).

²³¹ Ibid., 1.482 – 1 (d) (1). The content of each factor are discussed under Chapter 2.2.5.

²³² US Regs., 1.482 – 1 (d) (4) (i).

²³³ Ibid., 1.482 – 1 (e) (1).

²³⁴ Ibid., 1.482 – 1 (e) (2) (i).

a similar level of comparability and reliability.²³⁵ The arm's length range can be established in two ways. One way is through the results of every uncontrolled comparables that meet the following conditions: *"the information, on the controlled transaction and the uncontrolled comparables is sufficiently complete that is likely that all material differences have been identified, each such difference has a definite and reasonably ascertainable effect on price or profit, and an adjustment is made to eliminate the effect of each such difference"*.²³⁶ The other way is used in cases where the first method not can provide a satisfactory result. Here, statistical methods are used to increase the reliability of the arm's length range which excludes both ends of the range.²³⁷ This so called interquartile range is thus the range between 25 percent to 75 percent of results from the uncontrolled comparables, 25 percent being the lowest result obtained from an controlled comparable and 75 percent being the highest result derived from an uncontrolled comparable.²³⁸ When the result revealed in the transaction between the related enterprises falls within the arm's length range, adjustment will not have to be made. If the result however falls outside this range, the IRS can make an adjustment based on any value within the arm's length range. When the arm's length range is determined by the interquartile range, the adjustment made by IRS will normally be the median of all results.²³⁹

The transaction should in principle be determined on the basis of the data included in each transaction.²⁴⁰ According to the Regulations the taxpayer is however allowed to apply the pricing methods to multiple transactions which are interrelated, such as product lines or similar groups of products.²⁴¹ Furthermore, the Regulations state that data from multiple years may be considered. If multiple year data, relating to uncontrolled comparables is used, the taxpayer must consider data relating to the controlled taxpayer for the same years as well.²⁴²

7.3 Transfer Pricing Methods

When determining the arm's length price for transfer of goods, the Regulations set forth six methods: the CUP method, the RPM, the cost plus method, the Comparable Profit Method (CPM), the PSM and other unspecified methods.²⁴³

The CUP method, the RPM, the cost plus method and the profit split method function in the same way as the transfer pricing methods of the OECD TPG described in Chapter 4. The Regulations do however express the CPM method and other unspecified methods which need to be explained more thoroughly.

²³⁵ US Regs., 1.482 – 1 (e) (2) (ii).

²³⁶ Ibid., 1.482 – 1 (e) (2) (iii) (A).

²³⁷ Ibid., 1.482 – 1 (e) (2) (iii) (B).

²³⁸ Ibid., 1.482 – 1 (e) (2) (iii) (C).

²³⁹ Ibid., 1.482 – 1 (e) (3).

²⁴⁰ McDaniel, Ault, Repetti, *Introduction to United States International Taxation*, p. 148.

²⁴¹ McDaniel, Ault, Repetti, *Introduction to United States International Taxation*, p. 148 & US Regs., 1.482 – 1 (f) (2) (i) (A).

²⁴² US Regs., 1.482 – 1 (f) (2) (iii) (A).

²⁴³ Ibid., 1.482 – 3 (a).

7.3.1 The comparable profit method

Under the CPM the arm's length price is based on profit level indicators (PLI) derived from uncontrolled enterprises which are engaged in similar business activities under similar conditions.²⁴⁴ The arm's length result derives from the operating profit that the tested party would have gained on transactions with a related party if its PLI were equal to the PLI of an uncontrolled comparable. When calculating the operating profit of the taxpayer, the chosen PLI should only be applied to the financial data of the taxpayer which is related to the controlled transactions.²⁴⁵ Since CPM is a profit based method, it requires that one of the related parties must be the tested party, which means that its profits will be tested for fulfilling the requirements of the arm's length standard. According to the regulations the tested party should be the party whose operating profit can be confirmed using the most reliable data and needs the least adjustments, and for which trustworthy comparables can be found.²⁴⁶ The tested party will normally be "least complex party", which is the party that holds the least functions, assets and risks.

When selecting comparable enterprises from which a PLI will be determined, the comparability will accept product differences and to some extent functional differences.²⁴⁷ Comparability factors that should be emphasized are the size and scope of operations, lines of business, product and service markets involved, asset composition, and the age in the business product cycle. A greater degree of comparability between the tested party and the uncontrolled taxpayer provides a more reliable result when applying this method.²⁴⁸ Differences between the tested party and an uncontrolled comparable that materially affect the operating profit, determined by the relevant profit level indicator, must be adjusted.²⁴⁹

According to the Regulations, one PLI should be chosen for the arm's length range. The choice should be based on different factors such as the nature of the activities and on reliability of the data available.²⁵⁰ According to the Regulations the PLI alternatives are: Return on capital employed, such as the ratio of operating income to operating assets. PLI can also consist of financial ratios, for example the ratio of operating profit to sales (i.e., the operating margin) or the ratio of gross profit to operating expenses (i.e., the Berry Ratio).²⁵¹

The last step when applying the CPM is to use the best PLI to the comparable company operating profits in order to create an arm's length range. Generally, this range is determined by calculating the interquartile range from the comparable company operating profits. The interquartile range is usable provided that no less than four possible comparable companies can be identified. Since the comparability standards under the CPM is rather

²⁴⁴ US Regs., 1.482 – 5 (a).

²⁴⁵ Ibid., 1.482 – 5 (b) (1).

²⁴⁶ Ibid., 1.482 – 5 (b) (2) (i).

²⁴⁷ Levey, Wrappe, *Transfer Pricing: Rules, Compliance and Controversy*, p. 91.

²⁴⁸ US Regs., 1.482 – 5 (c) (2) (i).

²⁴⁹ Ibid., 1.482 – 5 (c) (2) (iv).

²⁵⁰ Ibid., 1.482 – 5 (b) (4).

²⁵¹ Ibid., 1.482 – 5 (b) (4).

broad, identifying four comparable companies might not be difficult and few companies will be able to use other methods.²⁵²

The IRS has broadly accepted the CPM. It has also been variously used by taxpayers because it is generally easy to apply. However, the CPM had not reached a universal acceptance in countries where the transfer pricing rules are based on the OECD TPG. According to the TPG the TNMM is instead preferred method which although is relatively similar in application.²⁵³

7.3.2 Unspecified methods

The Regulations also express that unspecified methods can be used when evaluating transfer prices.²⁵⁴ An unspecified method must, as all the specified methods, meet the best method rule.²⁵⁵

²⁵² Levey, Wrappe, *Transfer Pricing: Rules, Compliance and Controversy*, p. 93.

²⁵³ Ibid., p. 90.

²⁵⁴ US Regs., 1.482 – 3 (e) (1).

²⁵⁵ Ibid., 1.482 – 3 (e) (1).

8 Comparison between the Transfer Pricing Rules in Sweden, Finland and the US

8.1 Introduction

This chapter compares and analyzes the transfer pricing rules of Finland, Sweden and the US. The comparison is necessary in order to find out the similarities and differences in the different legal systems in order to establish a transfer pricing system acceptable to the tax authority in respective country.

8.2 Transfer Pricing Rules

Sweden, Finland and the US have imposed provisions against transfer prices that are not at arm's length. The provisions in Finland and Sweden are in their respective legal systems specific rules which are superior to general rules for tax purposes. The content of these provisions are also similar, the big difference is that the range of people falling under the scope of the provision is larger in the Finnish provision due to the term inner circle. The provisions apply furthermore to the same kind of transactions. Guiding case law in the transfer pricing area is rare in both legal systems, Sweden has however a few precedents of importance. Finland has furthermore additional provisions, which also can cover transactions between related enterprises that are not at arm's length. The transfer pricing rules of the US developed to a greater extent compared to Sweden and Finland. The regulations under the Code Sec. 482 give vast information and guidance on how the different transfer pricing methods should be applied.

8.3 Relation to the OECD TPG

Sweden and Finland are both members of the OECD and that fact alone indicates that the OECD TPG is of great importance when dealing with transfer pricing issues. Preparatory work to the transfer pricing legislation in respective country refers to the OECD TPG and express that they can be used as guidance when interpreting the arm's length principle. Additionally, the preparatory works as well as published material by the tax authorities in respective country stress that the transfer pricing methods of the OECD should be used when establishing transfer prices in accordance with the arm's length principle. Swedish case law does also state that the OECD TPG can be used as a guide when applying the domestic transfer pricing provision.

The US transfer pricing rules differ from the OECD TPG in that sense that it contains the best method rule without any hierarchy among the different transfer pricing methods laid down in the US Regulations. The Proposed revision does however contain a similar proposal which is the most appropriate method but stress that traditional transaction methods are preferable if the result of the profit based methods are equally reliable. Both the US regulations and the OECD TPG contain rules respective recommendations regarding the arm's length range. The provisions laid down in the US regulations is however more exhaustive. The transfer pricing methods of the US are quite similar to the methods set forth in OECD TPG. The big difference is that the CPM is expressed in the US Regulations and not in the OECD TPG. In practice the CPM is similar to the TNMM in application. The main difference is that the CPM can be used on a company wide basis which means that it focuses on comparable companies while the TNMM should be applied by comparing transactions. Thus, when properly applied, the CPM and the TNMM should provide the same result.

8.4 Conclusion

The countries Sweden, Finland and the US have addressed the problems with transfer pricing and imposed provisions in their respective legislation. Guidance on how to apply those provisions in Finland and Sweden are though deficient in both legal systems. In that matter different authorities in both countries refers to the OECD TPG. Consequently, Swedish and Finnish enterprises mainly have to rely on the OECD TPG when establishing transfer prices that are at arm's length. When developing a transfer pricing system, that is acceptable to the tax authorities, the transactions between Marine Food Oy and Marine Food AB, shall therefore be made with guidance from the OECD TPG. When it comes to the transactions between Marine Food AB and Marine Food LLC both the OECD TPG and the transfer pricing rules of the US must be taken into consideration.

9 Analysis

9.1 Introduction

Marine Food group has not yet set a standard for transferring goods and services between the companies established in Finland, Sweden and the US. In order to analyze the flow of goods and services the transactions between the different companies in Marine Food group need to be investigated separately. This chapter examines selection of method and comparables applicable on the transactions based on information from Chapter 3. The analysis starts with the transactions between Marine Food AB And Marine Food LLC and is followed by the various transactions between Marine Food Oy and Marine Food AB. The figures displayed in Chapter 3 regarding the transactions between the group members will be presented once again in order to recap the reader on the transactions being discussed.

9.2 Transactions between Marine Food AB and Marine Food LLC

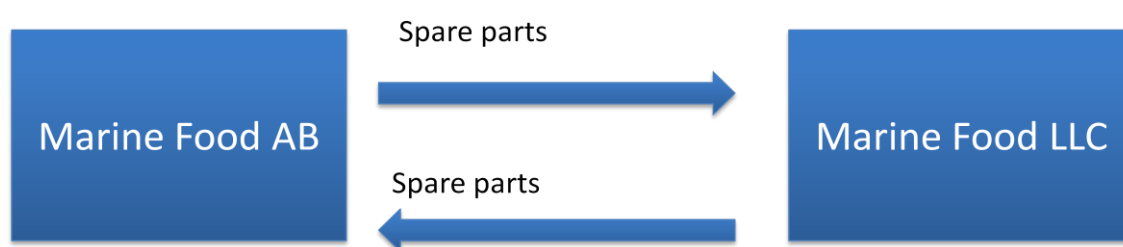


Figure 9-1 Overview of the transactions between Marine Food AB and Marine Food Oy

The transactions between Marine Food AB and Marine Food LLC consist of spare parts. As concluded in Sec. 3.5, Marine Food LLC is the least complex entity in this transaction and the value creating element is the after sales department which can be allocated to Marine Food AB. The next step is to determine a preliminary choice of method and at this point both the transfer pricing methods recommended by the OECD TPG and the methods and rules laid down in the US regulations shall be considered. In USA the best method rule exist, which means, as stated in Sec. 7.2, that the taxpayer should choose the best method to establish arm's length results. The best method does not have to be chosen by the inapplicability of other methods but if it later is revealed that another method is considered to be the best method, that method must be used. Complying with the best method rule means therefore that every method set forth in the US Regulations must be tested to ensure that the chosen method is the best method. The most appropriate method expressed in Proposed revision corresponds to some extent with the best method rule set forth in the US Regulations. One should however bear in mind that the most appropriate method still just is a proposal and not imposed yet along with the fact that the traditional transactional methods have preference over the profit based methods when providing equally reliable results.

The transactions between Marine Food AB and Marine Food LLC are not suitable for CUPs based on different reasons. One reason is that the scope of supply regarding spare parts varies and can not be standardized based on that the sales of the spare parts depends on what products break down and need to be repaired. Different vessels consist of different equipment, for example the equipment in cruise vessels has more complex features than equipment in merchant ships. The CUP is therefore not an appropriate transfer pricing method since there can be vast product differences. Another reason is that Marine Food AB

does not sell spare parts to third parties in the US but primarily to customers in Europe and there is hence a difference in the markets of buyers. Furthermore there are differences in volumes of transactions since only 10% of Marine Food group's net turnover consists of controlled transactions.

The transactions are not suitable for the cost plus method both since the manufacturer is not the least complex entity and it is not partly finished spare parts that are sold but rather fully produced products. Furthermore, Marine Food AB does not manufacture the products themselves but buys them from different suppliers why the cost plus method not is appropriate when making the preliminary choice of transfer pricing method.

The spare parts sold from Marine Food AB to Marine Food LLC are resold to US-based customers. Hence, the function of Marine Food LLC is primarily as a reseller of the spare parts why the RPM method may be appropriate to apply. Marine Food LLC neither add substantial value to the spare parts by physically adapting them nor using intangible property, such as marketing campaigns, to enhance the spare parts.

Marine Food LLC resells spare parts to third parties which are bought from suppliers like Marine Food AB. These independent enterprises are in the majority of cases US based suppliers. Hence, internal comparables for the purposes of the RPM exist and the resale price margins earned on those transactions can be used as a guide when establishing the transfer price between Marine Food AB and Marine Food LLC. The most important comparables under the RPM are functions, assets and risks since it most likely will affect the resale price margin more than for example differences in products. The level of operation may affect the resale price margin. As previously stated, Marine Food LLC is mainly acting like a reseller that does not take any considerable risks. The level of activity is however not merely as a forwarding agent since it holds certain functions. The resale price margin could therefore be reasonably low. If Marine Food LLC operates in a different manner in the transactions with independent enterprises, for example take more risks; the resale price margin might be affected. Furthermore, the levels of costs, for example transportation, warranty, and administration costs, are to be compared. Differences in these attributes that affect the resale price margin must be adjusted. Marine Food group should bear in mind that if they were to allocate more functions and risks to Marine Food LLC such as marketing or a warehouse function the resale price margin could not be as low. The different functions should as mentioned above be reflected in the resale price margin and with more functions comes more risks which Marine Food LLC should be compensated for.

If the internal comparables do not provide a reliable result external comparables must be found in order to justify the choice of method. It could be troublesome to find resale price margins in databases due to that the scope of costs of goods sold can vary. The search for independent enterprises should exclude enterprises that do not sell spare parts for galley equipment, for example enterprises selling spare parts to on-shore kitchens. There is diversity in the safety regulations in those types of equipment and they can therefore not be compared. To enhance the comparability further the search for independent enterprises should be limited to resellers in the US, where Marine Food LLC is situated.

The CPM is another method that may be applicable on the transactions between Marine Food AB and Marine Food LLC. The problem with applying CPM is that it is not a transfer pricing method acceptable to Swedish tax authorities since it advocates the transfer pricing methods of the OECD and the CPM is not a method recommended in the TPG. The CPM is however similar to TNMM in application and therefore a variant of the method could possibly be used to satisfy the Swedish tax authority and also the tax authority of the

US. As discussed in Sec 8.3, the TNMM compares transactions while the CPM focuses on comparable companies. This fact might lead to that the degree of comparability, required by the OECD TPG for the application of the TNMM, is not met when applying the CPM. Nevertheless, according to the best method rule in USA, the CPM must be tested to find out whether the outcome of applying the method will provide the best result.

The CPM is a profit based method and requires therefore that one of the related parties shall be the tested party, normally the least complex party. In this case Marine Food LLC is the least complex party and shall consequently be the tested party. For the purposes of CPM a PLI must be chosen for the arm's length range. The PLI chosen should only be applied on net profits that are connected with the transaction between Marine Food AB and Marine Food LLC. Differences in products, functions and risks are less important than under the other methods. Other factors that affect net profit should however be taken into consideration such as product market, competitive position, size and scope of operations and so forth.

When making a database search for independent enterprises, for the purposes of CPM in USA, companies that are active in the marine foodservice industry should be included. Companies that are operating in other industries as well, for example on-shore foodservice industry, should therefore not be included when making comparisons with independent enterprises. To enhance the comparability further the search should be narrowed to companies that both sells galley equipment and spare parts as well as carrying out installation works. Since the tested party, Marine Food LLC, is located in USA, the search should be narrowed to companies established in USA. Marine Food group is privately owned and to enhance the comparability the search for independent enterprises should only include privately owned enterprises. Marine Food LLC was established in 2004 and the years to be covered when making comparisons should be 2005, 2006 and 2007. The search should be narrowed to companies with available data from these years.

After a completed search an assumption is made that ten comparable companies have been found. Moreover, another assumption is that the PLI of Marine Food LLC is within the interquartile range derived from the independent enterprises that are included in the search. Consequently, the CPM provides a result that meets the arm's length standard and it would be an appropriate transfer pricing method to use in USA. Nevertheless, the result from the interquartile range can also be applied for the purposes of RPM in Sweden. The result of applying the RPM may differ from the outcome of CPM. However, if the result of the RPM in Sweden falls within the interquartile range in USA by applying the CPM in USA, the results should be acceptable to the Swedish tax authority and the tax authority in USA.

The PSM is not an appropriate method to use on the transactions between Marine Food AB and Marine Food LLC. The main reason is that the PSM is preferable in very integrated operations where both parties involved in the transaction add unique and valuable intangibles. Given that operations between Marine Food AB and Marine Food LLC is not very integrated together with the fact that Marine Food LLC does not add any valuable intangibles to enhance the spare parts, the PSM is therefore not a proper transfer pricing method for these transactions.

9.3 Transactions between Marine Food Oy and Marine Food AB

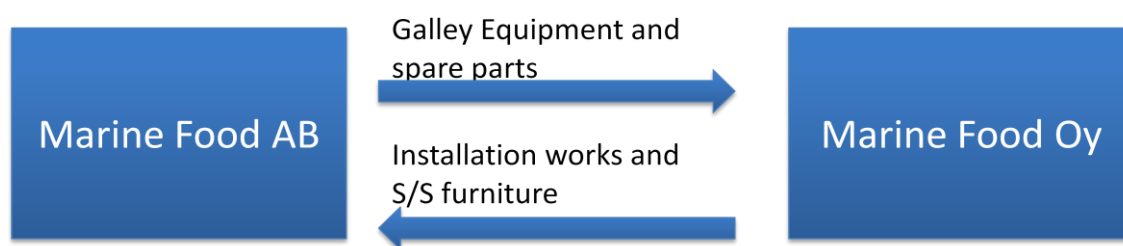


Figure 9-2 Overview of the transactions between Marine Food AB and Marine Food Oy

The transactions from Marine Food Oy to Marine Food AB consist of installation works and S/S furniture. The transfer of services (installation works) are closely linked with the transfer of property (S/S furniture). In these kind of situations, as discussed in Sec. 4.5, the principles of aggregation and segregation should be considered, which means that transactions should preferably be evaluated separately, apart from transactions that are so strongly connected that separate evaluations can not be made. The S/S furniture is only sold to Marine Food AB together with the installation works. However, there are cases when only the installation works is purchased from Marine Food Oy, while the S/S furniture is not. Based on these facts it can be determined that the transactions involving both installation works and S/S furniture can be separated why they further are going to be analyzed separately.

9.3.1 Installation works

Marine Food Oy sells services to Marine Food AB, which consists of installation works. As discussed in Sec. 4.5, there are two main issues when it comes to intra-group services, whether a service has been rendered or not and whether the charge for the service is in accordance with the arm's length principle. It is clear that Marine Food Oy provides intra-group services to Marine Food AB by installing galley equipment in vessels when, Marine Food AB has the responsibility for the total scope of the turnkey delivery. Independent enterprises would most likely satisfy the need for installing the galley equipment if not Marine Food Oy were to provide the service. Installations are also provided to third parties why a direct-charge method can be established in the transactions between Marine Food Oy and Marine Food AB. As stated in Sec 3.5, the least complex entity in the transactions regarding installation works is Marine Food AB. When making a preliminary choice of a transfer pricing method to apply on the installation works the TPG state that in most cases a CUP or cost plus method will be used.

CUP is not a proper transfer pricing method for the installation works. The main reason is that there are various differences in the scope of supply depending on what kind of vessel in which the galley equipment is installed. For example, the installations in cruise vessels are more sophisticated than installation in merchant ships since both the size and equipment of the different vessels vary to a wide extent. Hence, substantial product differences exist and CUP is therefore not appropriate to use. Another reason is that volume differences of transactions exist since only 10% of the group's net turnover consists of intra-group transactions.

The cost plus method is to prefer when the service provider is the least complex entity and does not use valuable intangibles when performing the services. The least complex party in this case is not the service provider, Marine Food Oy, but the recipient, Marine Food AB.

Furthermore, the value creating element in the transactions is the in-house competence and the great know how in creating sophisticated installation systems. The service provider in this case, Marine Food Oy, is consequently using valuable intangibles when providing Marine Food AB with the installation services. The cost plus method is therefore not an appropriate method to use.

Since it is difficult to apply the CUP method and the cost plus method the transactional profit methods, TNMM or PSM, could be applied. The PSM is recommended to use when transactions are interrelated and both parties add unique and valuable intangibles. The transactions regarding the installation works is neither interrelated nor does both parties, Marine Food Oy and Marine Food AB, add intangibles and the PSM is therefore not appropriate to apply. The remaining transactional profit method, TNMM, is more suitable for this type of transactions. The TNMM method requires a tested party which should be the least complex entity. As stated in Sec 3.5, Marine Food AB is the least complex party in this transaction and should therefore be the tested party. The net margin that Marine Food AB earns in the transactions with unrelated parties, which is connected with the controlled transaction, should therefore be compared to the net margin in the transaction between Marine Food AB and Marine Food Oy.

When Marine Food AB is responsible for the turnkey delivery one part of the contract concerns the installation of the galley equipment. The net margin earned on the installation part of the turnkey delivery could be compared to the net margin in the transaction between Marine Food Oy and Marine Food AB. However, it could be troublesome to separate the net margin on the installation from the net margin of the other parts of the turnkey delivery. In that case it could be preferable to use external comparables, thus net margins earned by unrelated enterprises in comparable transactions.

When searching for external comparables, companies installing on-shore kitchens can not be compared to installations of galley equipment due to vast differences in safety regulations and such enterprises should therefore be excluded. As discussed in Sec. 4.4.5, the net margin under the TNMM can be directly affected by a number of factors in the industry such as competitive position, threat of new entrants, threat of substitute products, varying cost structures and the degree of business experience. Marine Food group has many years of experience within the marine foodservice industry and work with top quality products that can be differentiated depending on the customers need. The reliability of a comparison would be greater if the independent enterprises do not operate with low quality products, are not newcomers on the market and are not limited to certain products, for example only fridges and freezers. Such differences would most likely require an adjustment if the business activities by Marine Food group and the business activities by compared independent enterprises differs in a way that have an effect on the profitability. The search for independent enterprises could also be narrowed down on a geographical basis meaning that enterprises not located in the Nordic countries should be excluded in order to enhance the comparability.

An appropriate profit margin indicator to use on transactions regarding services is full costs or operating expenses which could be applied in this case. Data from multiple years, both from the tested enterprise and the independent enterprises, should be considered when applying the TNMM. Marine Food AB was established in 2003 and when choosing the time period for analysis the first two or three years may not be included due to that the company was in the start-up phase and the profits from that time may not provide a true and fair picture. If the net margin earned by Marine Food AB falls within the range of results obtained, the transfer price between Marine Food Oy and Marine Food AB is at arm's length. The

TNMM is furthermore widely accepted by the Finnish tax authority and increases the appropriateness of using this transfer pricing method.

9.3.2 S/S furniture

Marine Food Oy is selling S/S furniture to Marine Food AB. These kinds of transactions only take place when Marine Food AB is responsible for the turnkey delivery and Marine Food Oy is performing the installations. The S/S furniture is further not sold to third parties. As stated in Sec 3.5, the least complex party in this transaction is the Marine Food AB.

The preliminary choice of transfer pricing method could exclude CUPs since Marine Food Oy does not sell S/S furniture to third parties and comparable transactions for the purposes of CUP do not exist. Moreover, it would be difficult to find independent enterprises that sell the exact same S/S furniture in the same market. The cost plus method is neither an appropriate transfer pricing method to apply given that the manufacturer, Marine Food Oy, is not the least complex entity together with the fact that the S/S furniture is fully produced products and not semi-finished goods.

The RPM may however be appropriate to use on these transactions. Marine Food AB acts like a distributor when purchasing S/S furniture from Marine Food Oy since it is resold to the end customer in the turnkey delivery. Marine Food AB does not add significant value to the product by physically changing the S/S furniture and does not use intangibles to improve the S/S furniture. As discussed in Sec 3.4.1, Marine Food AB does not merely buy S/S furniture from Marine Food Oy but also from unrelated enterprises depending on the situation. Consequently, internal comparables exist under the RPM and the resale price margin earned in those comparable situations may be used as a guide when determining the arm's length price between Marine Food Oy and Marine Food AB. When determining comparability differences in products, the S/S furniture, is less important than other comparability factors. Functions performed, assets used and risks assumed are comparability factors that are of greater importance for the purposes of RPM. As discussed above, the level of activity should also be compared under the RPM. Marine Food AB acts like a reseller but also takes quite significant risks, for example currency, credit and market risks, and holds important functions, for example marketing function, which should be reflected in the resale price margin. Hence, the resale price margin should not be too low but compensate Marine Food AB for holding important functions and risks. Furthermore, it is important to compare the level of costs, such as costs for distribution and administration. Marine Food AB could moreover be considered to have exclusive right to sell the S/S furniture since it is not sold to third parties. Such exclusive right should be taken into account when making comparisons under the RPM. The resale price margin may have to be adjusted if differences in functions and risks in the comparable transactions exist.

If the internal comparables can not provide a reliable measure of the arm's length price the next step is to search for comparable companies transferring S/S furniture to unrelated enterprises in relevant countries. Enterprises producing and selling S/S furniture used in on-shore kitchens can not be compared to S/S furniture in galleys due to vast differences in safety regulations why the search for independent enterprises should exclude such enterprises. To increase the reliability of the comparison the search for independent enterprises could also be narrowed down to cover Nordic companies since both Marine Food Oy and Marine Food AB is situated in Nordic countries. The search should furthermore be narrowed down to enterprises that produce its own stainless steel furniture. The internal comparables together with the search for comparable unrelated enterprises will provide a range

of resale price margins and if the transfer price established between Marine Food Oy and Marine Food AB falls within the range it can be considered to be at arm's length.

If the traditional transactions methods not result in reliable arm's length prices the transactional profit methods may be used as last resort. The PSM is not a proper transfer pricing method on these transactions since the transactions are not highly interrelated and Marine Food AB does not use unique and valuable intangibles in the transactions. The TNMM may however be applicable on these transactions. The least complex party in the transaction is Marine Food AB and should therefore be the tested party for the purposes of TNMM and is discussed above, the TNMM can also be used as a checking method for RPM. If the internal comparables can not provide a reliable result, external data needs to be examined in order to establish arm's length prices.

9.3.3 Galley equipment & spare parts

Galley equipment and spare parts are sold from Marine Food AB to Marine Food Oy when the latter is responsible for the turnkey delivery. Marine Food Oy does not purchase galley equipment and spare parts from other companies than Marine Food AB. As concluded in Sec 3.5, the least complex party and the one carrying the routine profit in these transactions is Marine Food Oy.

CUP is not an appropriate transfer pricing method to use the transactions due to a number of different reasons. There are first and foremost product differences because of the variation in the scope of supply. For example, galley equipment for merchant ships is more basic than for cruise vessels that is highly more sophisticated. Secondly, Marine Food AB's third party customers are primarily located in Asia when it comes to galley equipment and in Europe regarding spare parts and differences in the market cycle therefore exist. Furthermore the volumes differ significantly due to the fact that only 10% of the Marine Food Group's net turnover can be allocated to the controlled transactions.

The cost plus method is neither a proper transfer pricing method since the least complex entity in this case is not the manufacturer along with the fact that the galley equipment and spare parts is not semi-finished but fully produced products. Furthermore, Marine Food does not manufacture galley equipment and spare parts itself but purchase it from different suppliers.

The preliminary choice of transfer pricing method can however be the RPM. The galley equipment is sold to Marine Food Oy when it is responsible for the turnkey deliveries and is forwarded from Marine Food Oy to the end customer. Marine Food Oy works thereby as a reseller why the RPM could be an appropriate method to use on these transactions. When making comparisons under the RPM differences in products, galley equipment and spare parts, is less important than differences in functions and risks. Differences in functions and risks, between Marine Food Oy and the comparable companies, might have to be adjusted if it materially affects the resale price margin. Furthermore, it is important to the level of activity for the purposes of RPM. Marine Food Oy operates like a reseller but also holds important functions, such as R&D function, and takes significant risks which should be reflected in the resale price margin. If the level of activity differs in the comparable transactions which materially affect the resale price margin, adjustments must be made to account for those differences. As mentioned in Sec 3.4.2, Marine Food Oy do not purchase galley equipment and spare parts from third parties. Consequently, internal data can not be guiding when determining the transfer price between Marine Food AB and Marine Food Oy.

External comparables can be difficult to find since the costs of goods sold can vary between different enterprises. When searching for external comparables it is important to find companies with the same functions and risks. Companies that should be included in the comparison are only those selling galley equipment and not companies that for example sell kitchen equipment with belonging spare parts. The comparisons would not be reliable since there are significant differences in galleys and kitchens due to safety regulations. To enhance the comparability the search can be narrowed by only including resellers established in the Nordic countries since Marine Food Oy is situated in those countries.

The transactional profit methods, PSM and TNMM could be applied in case the results derived from applying the RPM are not reliable. The PSM is not appropriate to use because that method is best applied when integrated operations is at hand and both parties use unique and valuable intangibles which is not the case regarding these transactions. The TNMM could however be applied on these transactions, either solely or as a checking method for the RPM. As discussed above, the TNMM requires a tested party which should be the least complex party, which in this case is Marine Food Oy. Since internal comparables does not exist the comparable transactions need to be obtained from external data through database searches.

Another aspect for Marine Food group to consider is reorganizing the sales function regarding the galley equipment. Since a lot of the transactions with third parties is conducted with Asian enterprises it could be a good idea moving the sales function of the galley equipment to the Singapore based enterprise Company SEA Pte. The market indicates a location shifting from Europe to Asia in the future and it is important to stay competitive and follow the oscillations on the market. A tax planning aspect of such reorganization is that Singapore does have a fairly lower tax rate than Sweden,²⁵⁶ which in the long run would increase revenues for the group.

²⁵⁶ According to Ernst & Young, *The 2009 worldwide corporate tax guide*, (EGYM Limited, 2009) the Corporate Income Tax Rate is 18% in Singapore (p.881) compared to 26,3% in Sweden (p. 955).

10 Conclusion

This master's thesis is dealing with how to develop a transfer pricing system from a practical point of view. Marine Food group which is active within the marine foodservice industry is established in Finland, Sweden, USA and Singapore. The company situated in Singapore is recently established and no intra-group transactions have been conducted yet. The group has not yet established a transfer pricing system for the transactions between the companies established in Finland, Sweden and USA. The purpose of this thesis is therefore to develop a transfer pricing system for these transactions which is acceptable to the tax authority in respective country. After analyzing the different transactions in previous chapter, this concluding chapter will recommend a transfer pricing system which is relevant for Marine Food group's various transactions.

The transactions between Marine Food AB and Marine Food LLC have been analyzed by considering both the transfer pricing rules of Sweden and the US. The OECD TPG should according to Swedish legal system be guiding when dealing with transfer pricing issues. The transfer pricing system for these transactions is therefore also established with reference to the OECD TPG. The transactions between Marine Food AB and Marine Food LLC consist of spare parts. The CPM meet the best method rule laid down in the US Regulations and should therefore be applied in the US. The transfer pricing method that should be applied in Sweden on these transactions is the RPM since Marine Food LLC operates like a reseller for the spare parts. Internal comparables exist and comparability for the purposes of RPM can be established with reference to both internal and external data.

When investigating the various transactions between Marine Food AB and Marine Food Oy the OECD TPG is a source of great importance since both Sweden and Finland advocate the recommendations in its respective legal systems. Consequently, the OECD TPG is studied when establishing the transfer pricing system for these transactions. The transactions from Marine Food Oy to Marine Food AB include both S/S furniture and installation works and these different types of transactions should be investigated separately. The installation works are a service which has been rendered by Marine Food Oy. The most appropriate transfer pricing method to use on the installation works is the TNMM method. Marine Food AB is the least complex party and should therefore be the tested party. The net margin that Marine Food AB earns in the transactions with unrelated parties, which is connected with the controlled transaction, should hence be compared to the net margin in the transaction between Marine Food AB and Marine Food Oy. If the internal comparables can not provide a reliable measure of an arm's length result, net margins earned in external comparable situations should be applied when determining comparability. The S/S furniture should be priced according to the RPM since the goods are resold from Marine Food AB. In this case, comparables can be derived from internal data and comparability can therefore be determined by referring to both internal and external comparables.

The transactions from Marine Food AB to Marine Food Oy consist of galley equipment and spare parts and the least complex party in these transactions is Marine Food Oy. The transfer pricing method that should be used in this case is also the RPM. Marine Food Oy operates as a reseller when buying galley equipment and spare parts from Marine Food AB why this method is favorable. Comparable resale price margin should be derived from external comparables since internal comparables do not exist.

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Appendix 1 – List of specific features for Marine Food Groupservice equipment

- IEC²⁵⁷ 46 norms according to IEC 92 amendment 101, 104 and 307.
- All cables are brought together as much as possible into wire harnesses and are fixed every 100 mm. by cable ties.
- Electrical filters must be built-in for minimizing magnetic fields that could disturb navigational devices.
- Marine feet for deck fastening, either by screwing or welding.
- Rolling racks around all cooking plates on ranges.
- Deep fryers must be built according to SOLAS²⁵⁸-regulations, which means a back up thermostat, audible alarm and connection for visible alarm as well as connectivity to separate or integrated fire extinguisher.
- All electrical connections are secured by feather or tooth washers to avoid losing from vibrations to avoid melting of components.
- All necessary doors are equipped with marine stops to avoid opening or closing during heavy sea.
- All guides on guide racks have installed stoppers to avoid goods slipping off during heavy sea.
- Major cabling made of halogen free cables.
- Panelling around the major equipments is made of stainless steel.
- Solenoid valves for dishwashers in running through a delay timer making the filling smoother during heavy sea.

²⁵⁷ IEC: International Electrotechnical Commission.

²⁵⁸ SOLAS: International Convention for the Safety of Life at Sea, by International Maritime Organization, IMO firstly adopted in 1974.