

Transfer Pricing in Intra-Group Transactions:

How to Mitigate Tax Risks Without Creating Bureaucracy in Your Company?

A Crash Course into Transfer Pricing

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Thank you for cooperation



“

...transfer pricing is not an exact science but does require the exercise of judgment on the part of both the tax administration and taxpayer.

Point 1.13, OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022

”

Contents

1. Key transfer pricing (TP) requirements in Lithuania
2. How to assess and calculate TP risks
3. How to evaluate an adequate level of detail for TP documentation
4. Pragmatic solutions to mitigate key TP risks



1.

Key source of transfer pricing (TP) requirements in Lithuania (based on OECD)

1.3. Finance Ministry Order re Transfer pricing (LT Rules)

Summary version from 01.01.2021

The order was published: Gazette. 2004, no. [58-2074](#), up to 1042050ISAK001K-123

New version from 01.01.2019:

No. [1K-470](#), 31/12/2018, published in the TAR 31/12/2018, until 2018-22117

MINISTER OF FINANCE OF THE REPUBLIC OF LITHUANIA

ORDER

**ON THE APPROVAL OF THE RULES FOR THE IMPLEMENTATION OF ARTICLE 40,
PART 2 OF THE PROFIT TAX LAW OF THE REPUBLIC OF LITHUANIA AND ARTICLE 15,
PART 2 OF THE PERSONAL INCOME TAX LAW OF THE REPUBLIC OF LITHUANIA**



<https://www.e-tar.lt/portal/lt/legalAct/TAR.55EC668C883A/asr>

“

Purpose of transfer pricing in tax area – to prove that analyzed transaction can be concluded for the same price even between non associated persons. Tax authorities will evaluate skeptically and will try to prove otherwise.

”

1.

Regional Nordic-Baltic context: higher thresholds for TP

Exemptions or simplifications to all the small and medium enterprise (SME) category in the Nordic-Baltic region:



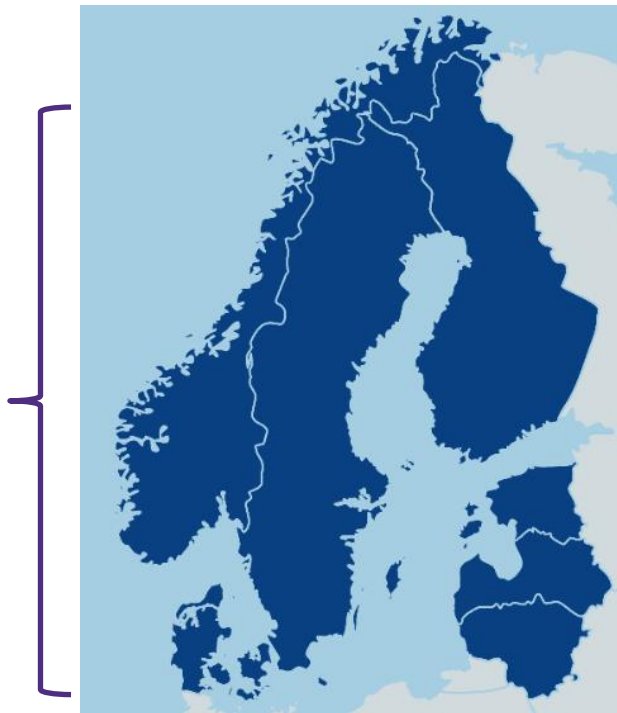
< 250 employees



< 32-50 m EUR revenue
(x10 vs. LT!)



< 16-43 mln. EUR assets



Lithuania,
Latvia – stricter
approach and
lower
thresholds

2. How to assess TP risks?

Before jumping into TP documentation preparations:

1. Evaluate what are the economic risks or possible sanctions that could be faced through having inadequate intragroup transaction pricing or not complying with other TP documentation requirements if asked by tax authorities.
2. Evaluate the chances of being audited by the tax authorities in the first place, are there any „red flags“?

2.

How to calculate economic TP risks?

Transaction	Value, EUR	Potential adjustment	Tax correction, EUR	15% corporate income tax effect, EUR	Late payment interest, EUR per annum
1. Loan, @5%	100 000	+/-2%	2 000	300	32
2. Sale of goods	100 000	+/-5%	5 000	750	83
3. Rent	100 000	+/-10%	10 000	1 500	165
4. Services / management fees	100 000	+/- 20%	20 000	3 000	330
5. Royalties	100 000	+/- 30%	30 000	4 500	495

N.B. table above is for illustration / indicative purposes only

2.

Key risks to consider...

- Losing of **reliable taxpayer** status -> exclusion from public tenders
- Tax penalties increased from 10-50% until 1st May, to **20-100%** since 1st May (of the unpaid tax)
- Aggravating circumstances for tax penalties:
 - More than 24 500 EUR of unpaid tax – „high damage to state budget“
 - Willingness to obtain tax advantage
 - Incomplete accounting or lack of transfer pricing documentation
 - Non-cooperation
 - Accounting documents showing not real operations etc.

2.

Risks assessments example – what do the tax authorities see in tax return annex?

Risks identification in the FR0528 form (annex to PLN204 tax return)

Data regarding sales (transfers) transactions with associated parties		Income	Costs	Number of completed transactions	Codes*
12	Sale (transfer) of non-current tangible assets to an associated party (AA)				<input type="checkbox"/>
13	Sale (transfer) of non-current intangible assets to an associated party AA				<input type="checkbox"/>
14	Sale (transfer) of goods, production or inventory AA	1 6 5 4 8 9 6	1 6 5 5 4 2 0	5 9 3	3 <input type="checkbox"/>
15	Provision of financial services AA				<input type="checkbox"/>
16	Provision of other services AA		3 4 5		2 3 <input type="checkbox"/>
17	Sale (transfer) of financial assets AA				<input type="checkbox"/>
18	Rental engagements AA				<input type="checkbox"/>
19	Other transactions AA				<input type="checkbox"/>

More expenses than revenues – loss-making transactions?

“3” code – failure to apply TP methods

2.

Risks assessment – what smart tax inspectors evaluate first

1. *Loss-making transactions (e.g., If contract manufacturer performs a loss-making supply, loss-making supply of goods / services)*
2. *Purchases of services where there is no evidence of receipt and pricing of those services (management fees, etc.)*
3. *Interest-free loans, or conversely - loans with very high interest rates*
4. *Intangible asset transactions (transfers or royalties) (e.g., a self created trademark is transferred to Cyprus and large royalties are subsequently paid)*

3.

How to evaluate an adequate level of detail for TP documentation

The procedure for preparing TP documentation is described in Chapter V of the LT Rules (paragraphs 77-93).

“78. Pricing documents must contain information relevant to the pricing of transactions **available at the time of the transaction**. However, (...) subsequent information may be provided if it reveals circumstances relevant to the pricing of the controlled transaction. ”

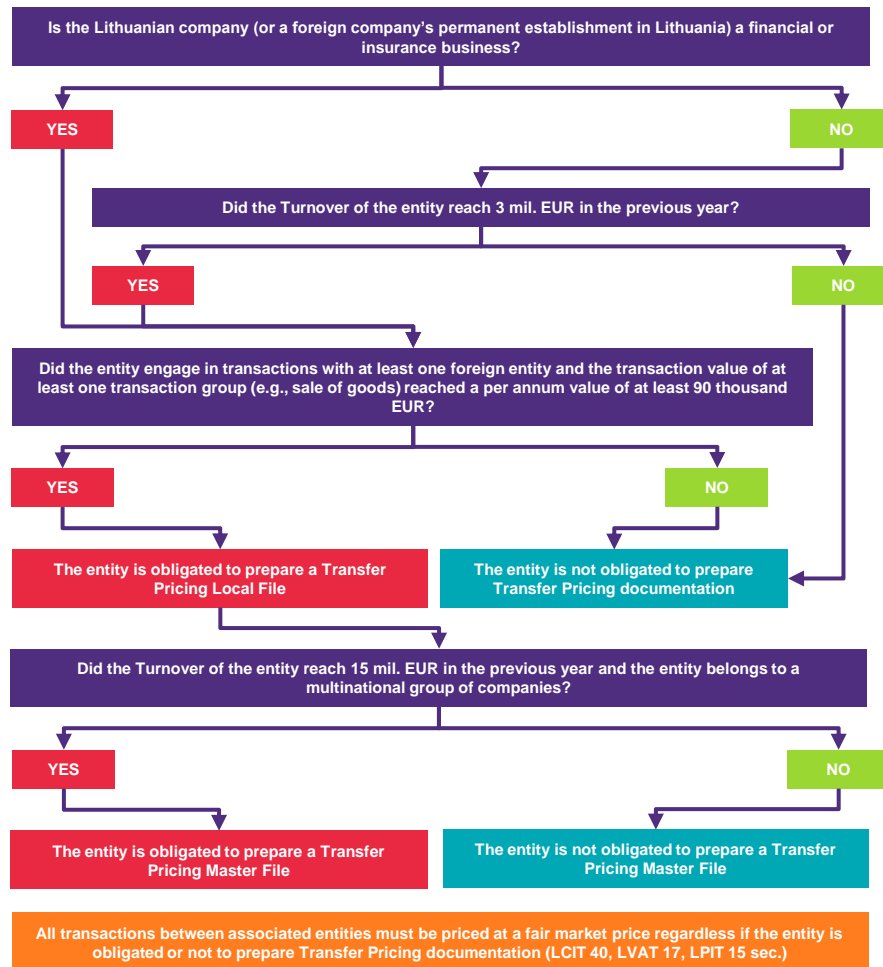
3. Preparing of TP documentation

1. Master file - obligatory for units and permanent establishments with turnover in Lithuania last year **>15m EUR**.

2. Local file - mandatory for units and permanent establishments with an income of **> 3m EUR** past year.

+ for financial companies and credit institutions, insurance companies **<3m EUR**.

TP documentation is not required if the transactions are only with LT taxpayers and if the value of the controlled transaction or their group is **<90k EUR** (except if transactions with tax haven country).



3.

Preparing of TP documentation Master File

The Master file contents:

- Info / diagrams on the organizational, legal and operational structure of the group;
- supply chain information of the most profitable goods / services;
- information on important factors determining the group's profit;
- descriptions of major geographic markets;
- analysis of the functions of group units, contributions to value creation;
- information on significant business reorganizations, acquisitions / disposals;
- descriptions of significant transactions for the provision of controlled services (incl. Description of the service provider's capacity, cost allocation, etc.) (continued on next page).

3.

Preparing of TP documentation Master File (continued)

The Master file contents:

- Lists of intangible assets + data on royalties received / payable, R&D strategy, location of R&D equipment, etc. Info on financing transactions (inside and outside the group), their general pricing policy, who carries out a centralized fin in the group. function, etc.
- Indicate relevant agreements with other countries' tax administrations on pricing principles for future transactions, etc.
- If it is not possible to obtain information from the group, it is necessary to indicate the reasons for not receiving the information upon request of the tax authorities.

3.

Preparing of TP documentation Local File

The Local file must contain information on:

- The controlled transaction and its 5 comparability factors;
- Pricing method and reasons for its choice;
- Method application information and calculations, adjustments;
- Selected tested party and comparative data;
- Comparable transaction information and analysis of their 5 comparability factors;
- Comparative search quantitative and qualitative selection steps, criteria, rejection reasons, calculations and adjustments;
- Dates of preparation, updating and change of pricing documentation;
- Other info (e.g. performance analysis, etc.).

3.

Preparing of TP documentation – How Frequently to Update

Update frequency:

- Data of the controlled transaction **must be updated for each tax period;**
- Benchmarking studies, comparability data can be updated at **least every 3 years, if the economic conditions in the market do not change significantly!**
- E.g., Covid-19 pandemic requires remaking benchmarking study



Preparing of TP documentation - deadlines

Deadline for TP documentation preparation - by the sixth month of next year, 15th day (Same deadline for income tax return, **15 June** if financial year=calendar year).

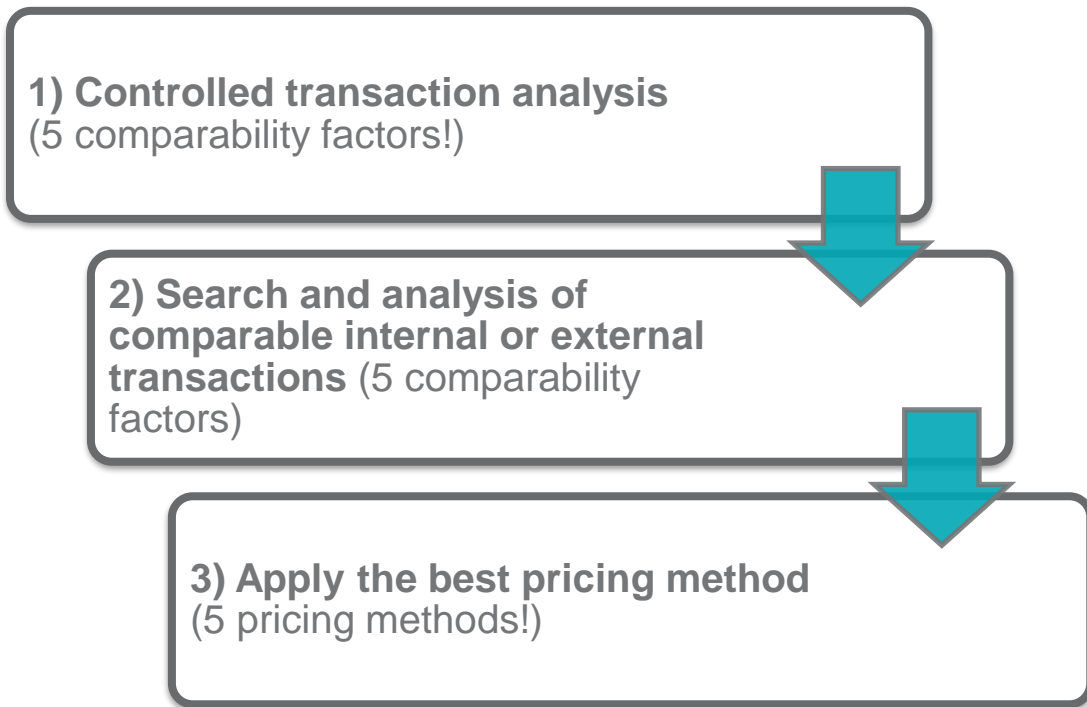
Submission obligation:

Within 30 days of the request from the tax administrator

The tax administrator may request a translation into Lithuanian, the deadline is then set separately.

4.

Pragmatic solutions to mitigate key TP risks: analysis process



4. Comparability Factors

When evaluating a transaction, the factors below must be assessed (information known to the parties at the time of concluding the transaction):

- characteristics of the property or services transferred;
- functions, assets, risks performed by parties (functional analysis);
- contractual terms of the transaction (can also be verbal/non-written terms);
- economic circumstances of the parties (e.g. seasonality);
- business strategies pursued by the parties (e.g. "market entry", etc.).

(More details - 7-13 of the LT Rules)

4. Comparability factors

Other relevant factors (examples, non-exhaustive list):

- Loss-making (it can be better to provide at a loss than not to receive any income during the whole period, etc.);
- State regulation (high specificity, in a regulated market niches, in more regulated states etc.);
- Local market aspects (e.g. for services from LT to Scandinavia, prices are lower than for Scandinavian providers of similar services);
- Business Synergies;
- Logistics costs;
- Customs aspects (e.g. supplies to the US via Canada due to more favorable tariffs, etc.).

4.

Transfer pricing methods

Five transfer pricing methods:

1. Comparable Uncontrolled Price (CUP);
2. Resale price method (RPM);
3. „Cost plus“;
4. Profit split;
5. Transactional net margin method (TNMM).



Traditional methods

Transactional profit methods

+ other generally accepted methods of determining financial value, choosing assumptions and indicators compatible with the arm's length principle.

- Taxpayer can choose to use one method or several methods combined.
- If "traditional" and „transactional" methods can be used with equal reliability, then "traditional" methods should be used, among which CUP is the most reliable.

4.

Five transfer pricing methods recap in more practical terms

- 1. Comparable Uncontrolled Price (CUP);** (price in EUR / unit, EUR / kg, etc.)
- 2. Resale price Method (RPM);** (gross margin)
- 3. „Costs plus,, (CPM, C+);** (gross mark-up)
- 4. Profit split (as joint venture / intertwined,%, intangible assets)**
- 5. Transactional net margin method (TNMM)** (EBIT margin, Net Cost Plus markup, Berry ratio, etc.)

4.

Transfer pricing methods: Transaction net margin method (TNMM) (EBIT margin etc.)

- TNMM is the most frequent method. It examines whether the net margin of a controlled transaction is in line with the arm's length principle (margins of similar companies but without having associated parties). The net margin on a transaction is the portion of the net profit on the transaction that should be earned based on certain metrics.
- The choice of the profit level indicator must take into account the results of the functional analysis of the controlled transaction, the type of transaction, the availability and reliability of the information required to calculate the indicator, and the advantages and disadvantages of the indicators.
- Most often used profit level indicators (PLIs):
 - **EBIT margin** = Earnings Before Interest and Taxation „EBIT“ / Sales;
 - **Net Cost Plus mark-up** = Earnings Before Interest and Taxation „EBIT“ / (Cost of goods sold + Operating expenses);
 - **Berry ratio** = Gross profit / Operating expenses

4.

Transfer pricing methods: Transaction net margin method (TNMM) (EBIT margin etc.)

Summary Overview

Return on Sales	Average 3 years	2016	2017	2018
Range	Results	Results	Results	Results
Number of companies	5	5	5	5
Maximum	13.96 %	11.50 %	16.62 %	13.65 %
Upper IQ	13.04 %	11.15 %	13.73 %	13.61 %
Median	4.66 %	3.62 %	5.66 %	6.47 %
Lower IQ	4.50 %	3.36 %	4.78 %	5.37 %
Minimum	3.77 %	0.03 %	2.95 %	4.90 %

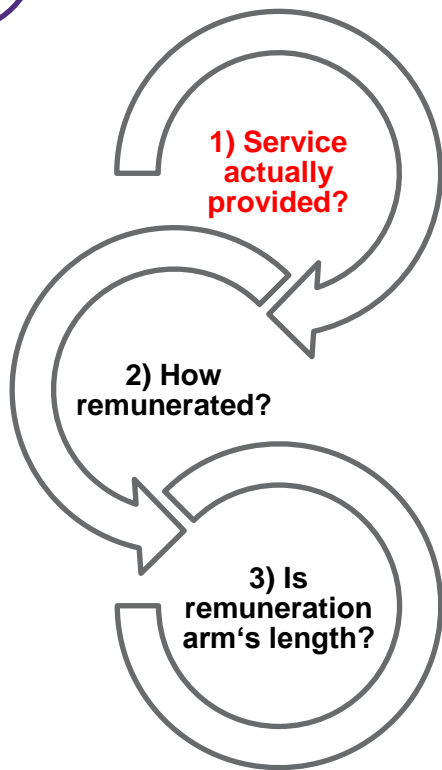
In this example extract from benchmarking database is shown, having processed large list of potentially comparable companies, by the end 5 comparable companies remain and their arm's length range is from 4.4% up to 13%.

Detailed Overview

Benchmark Analysis (Interquartile Range)				
Return on Sales	Average 3 Years	2016	2017	2018
Companies (5 / 5)	Results	Results	Results	Results
<input checked="" type="checkbox"/> FUTURO LUCE S.R.L.	4.50 %	3.62 %	4.78 %	4.90 %
<input checked="" type="checkbox"/> Keemple Polska Sp. z o.o.	4.66 %	3.36 %	5.66 %	5.37 %
<input checked="" type="checkbox"/> Altori Sp. z o.o. S.K.	13.96 %	11.15 %	16.62 %	13.61 %
<input checked="" type="checkbox"/> LED LUKS, proizvodnja svetil, d.o.o.	3.77 %	0.03 %	2.95 %	6.47 %
<input checked="" type="checkbox"/> Matrel Oy	13.04 %	11.50 %	13.73 %	13.65 %

4.

Intra-Group Services



If the service is not actually provided - **no deductions are allowed, purchase VAT is not deductible!**

The service is provided if:

- economic or commercial benefits have been or will be obtained;
- only access to the service was obtained, even if it was not used.

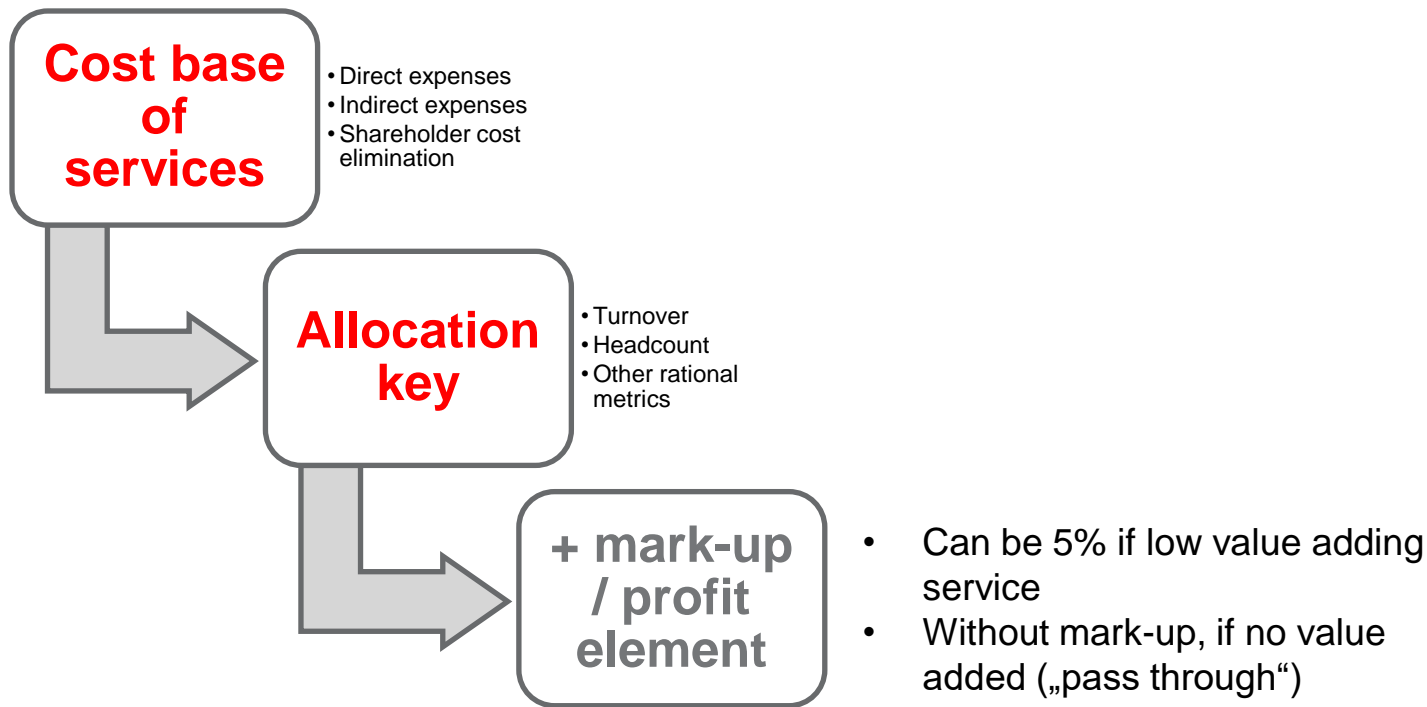
The service is not provided if:

- Non associated person would not purchase the service;
- received benefits only for shareholders, not for the company;
- duplication services (there are exceptions);
- only incidental benefits were obtained;
- to benefit another person (e.g. shareholder).

(LT Rules 69-73).

4.

Intra-Group Services – indirect charge method



4.

Manufacturing transactions – applicable methods

- 1. Comparable Uncontrolled Price (CUP)** - if there are internal or external comparisons of prices of identical products between non-associated persons.
- 2. 'Cost plus' (CPM, C+)** - if there are internal or external comparisons of gross mark-ups for similar production services
- 3. Transaction Net Margin (TNMM)** - most commonly used - external comparisons of net mark-ups from similar manufacturers are searched in the AMADEUS database (NET COST PLUS MARK-UP = $EBIT / (COGS + OPEX)$)

4.

Trade / distribution transactions - applicable methods

- 1. Comparable Uncontrolled Prices (CUP)** - if there are internal or external comparison of prices of identical products between non-associates.
- 2. Resale price method (RPM)** - if there are internal or external comparisons of the margins of similar distributors
- 3. Transaction Net Margin (TNMM)** - Most Applicable - The AMADEUS database benchmarking for external comparison with EBIT margins of similar distributors (EBIT / SALES)

4.

Financing (loan) transactions - applicable methods

1. Comparable Uncontrolled Prices (CUP):

- Internal comparisons (eg bank funding, or funding offer)

- External comparisons:

a) **Statistics of the Bank of Lithuania, ECB statistics, statistics of other countries;**

b) **Specialized databases** (CUFT Analytics, LoanConnector), according to the creditworthiness of the beneficiary, etc. parameters



4.

Financing (loan) transactions - e.g. Statistical tables of the Bank of Lithuania



Measurement units: Percent per annum (units)

	03/2022	04/2022	05/2022	06/2022	07/2022	08/2022
Loans ¹ to non-financial corporations and households ²	3.23	3.14				
Loans ¹ to non-financial corporations	3.14	2.77				
Up to 1 year initial rate fixation	3.00	2.97				
Over 1 year initial rate fixation	4.98	2.18				
Loans up to EUR 1 million	2.90	2.98				
Loans over EUR 1 million	3.28	2.68				
Up to 1 year initial rate fixation	3.13	2.89	2.23	2.69	3.08	3.62
Over 1 year initial rate fixation	5.34	1.87	6.01	6.07	6.60	5.25

It is important to choose the right table, according to the type of recipient, the amount, pal. rate fixation period, as well as the use of several months. average.

Source: <https://www.lb.lt/lt/pinigu-finansu-istaigu-paskolu-ir-indeliu-palukanu-normu-statistika-2>

4.

Intangible assets transactions

- **The DEMPE concept - "development, enhancement, maintenance, protection and exploitation"** (LT Rules 58-67) - requires the identification of entities performing functions related to the creation, development, improvement, maintenance, protection and use of intangible assets and taking risks.
- Cost-based methods are not recommended
- A “profit-split” method is possible, but in practice it is difficult to apply it reliably (often involves subjectivity)

4. Intangible assets transactions

- Possible practical solution - search RoyaltyRange or similar databases
- Disadvantage – it does not reflect the real value of the intangible asset, which is crucial (if the intangible is insignificant, the remuneration for it can be small to none)

(N.B. transfer triggers notification (DAC-6))

One Search

Use this form to place a request for One Search. Within hours, you will receive a detailed list of reports from our search at **no cost**. If you are happy with the results of our search, you can then choose to pay for and download the data for a fee of **€600**. The fee for an optional write-up is **€200**.

Select a database

ROYALTY RATES

LOANS INTEREST RATES

SERVICE FEES

Select criteria

Type



Keywords



Time for your inspiring questions

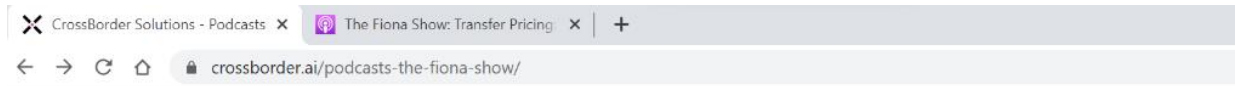




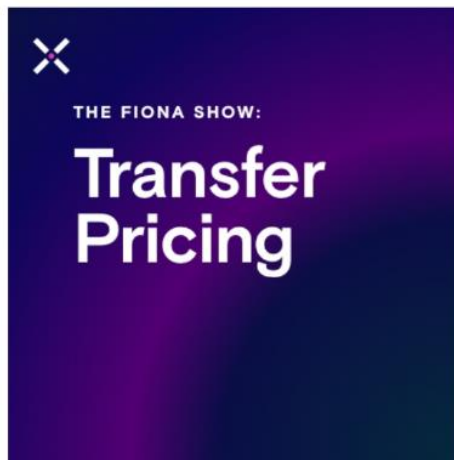
Additional resources

Weekly podcast *The Fiona Show: Transfer Pricing*

<https://crossborder.ai/podcasts-the-fiona-show/>



Tune in every week to hear leading experts in their field take the uncertainty out of the changing tax industry. Listen on [Apple Podcasts](#) or [Spotify](#).



LATEST PODCAST

Episode 117: Transfer Pricing New Year's Resolutions

Here, are a few best practices for 2022 that every transfer pricing professional should embrace.

[LISTEN ON APPLE PODCASTS](#)

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Additional resources

World Tax World TP

ITR

Direct Tax Indirect Tax T

Top 10 TP cases of year 2022:

<https://www.internationaltaxreview.com/article/2b084jo84g8kvu2fjqfi8/top-10-transfer-pricing-cases-from-2022>

ITR picks 10 cases that made the headlines, with McDonald's France, BlackRock, and Maersk Oil and Gas all making the list.

It's time for *ITR*'s annual review of the biggest transfer pricing disputes of the year.

Once again, multinationals found themselves up against determined tax authorities in high-stakes cases across the world. In some instances, courts were asked to intervene and settle the issues in dispute.

All in all, it was a busy year for tax officials and judges, so here is a recap of the most important cases.

Australia v Rio Tinto

On July 20, Rio Tinto agreed to pay **A\$613 million (\$424 million)** to the Australian Taxation Office following a dispute concerning profit-shifting allegations against the global mining company.

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