LUKOIL Benelux B.V.

Definition of an optimal transfer pricing method for LUKOIL Benelux B.V., as a subsidiary of LITASCO SA

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Executive summary

Globalization of the economy, which resulted in a free flow of funds, has led to a dramatic increase of both the number and the economic power of multinational enterprises ("MNE") over the past three decades. With the increasing number of MNEs, the number of transactions between entities belonging to the same multinational group goes up as well. Intercompany transactions generally enable companies to shift income from one jurisdiction to the other. Income shifting can be driven by various tax aspects such as a tax rate differential, or by firm-specific tax attributes like tax losses. At the same time, profit shifting imposes risk to governments as it may reduce tax revenues. As a result, an increasing number of governments are therefore introducing and extending transfer pricing regulations in order to combat profit shifting through intercompany transactions.

The thesis explores the area of transfer pricing and applies the transfer pricing theory to the particular case of two companies Lukoil Benelux B.V. and LITASCO SA.

Lukoil Benelux B.V. ("LBBV" or the "Company") was established in 2001 and has been a subsidiary of the main company of the LITASCO Group called LITASCO SA ("LITASCO"). Situated in Rotterdam, the biggest port of Europe, LBBV mainly provides supporting activities for the parent company LITASCO, which is located in Geneva, Switzerland. LBBV is engaged in the physical supplies of bunker fuels and bunker trade (back-to-back trade in bunker fuels and gasoils) in the region of Amsterdam-Rotterdam-Antwerp ("ARA")). What is more, LBBV is responsible for the operational and logistical support for LITASCO's trade of oil products on barges in ARA region.

The main research objective of the thesis is "to define an optimal transfer pricing method for Lukoil Benelux B.V., a subsidiary of LITASCO SA, with regard to rules and regulations set by Dutch Tax Authority". The optimality of the transfer pricing is determined by two criteria: applicability of transfer pricing method and numerical value of the transfer price.

The corporate tax in the Netherlands is 25%, while that in Switzerland is substantially lower, normally making 11%. As a result, LITASCO is interested in shifting taxable income of LBBV to itself because in this way the tax outlays of LITASCO Group will be lower and net income higher. At the same time, OECD guidelines, first report on transfer pricing, have extended their regulation and adopted an "arm's length principle", a rule that states that the prices between the entities of a group have to be that same as they would have been if the parties of transaction had not been related to each other

In order to achieve the main research objective, the following research objectives were designed:

1. identify what transfer pricing methods exist
2. observe relative strengths and weaknesses of each transfer pricing method
3. find out the rules and regulations imposed by the Netherlands, regarding the applicability of transfer pricing
4. determine the main activities of LBBV
5. define how to calculate the arm's length price under each transfer pricing method

In the beginning, the literature and academic sources from which the data can be obtained in order to achieve the research objectives are described. The literature focuses on the theory of transfer pricing, namely the transfer pricing methods, their relative strengths and weaknesses and legislation in the Netherlands concerning transfer pricing. The theory of transfer pricing is comprehensively described and explained in secondary sources and OECD guidelines, which are the most official document on transfer pricing. What is more, the thesis considers the main

activities of LBBV and their content in order to make inferences about which of the activities are subject to transfer pricing.

Further, the research strategy that enables to gather data that can provide answers to the research questions is described. A set of primary and secondary sources is used in obtaining data relevant to the topic. For instance, primary sources such as the reports issued by leading auditing companies are used in order to obtain relevant data about rules and regulations on transfer pricing in the Netherlands. Books and other secondary sources were used to develop a theoretical background on transfer pricing, transfer pricing methods and their application. What is more, in order to find out more information about the LBBV, an in-depth interview with the Acting Managing Director of LBBV is conducted.

The fourths chapter provides the findings that have been revealed during the process of the research with the use of various data collection techniques. To start with, it was revealed that there five transfer pricing methods, which are divided into traditional and transactional. Traditional methods include comparable uncontrolled price method, resale price method and cost plus method. Transactional methods consist of profit split method and transactional net margin method. In addition to this, the rules and regulations regarding transfer pricing such as priority among methods and justification of the transfer pricing methods have been found. In detail, the government body responsible for transfer pricing regulations is called Dutch Tax Authority and it does not prioritize among transfer pricing methods if the tax paying company will reasonably justify the choice. As for the relative strengths and weaknesses of each transfer pricing method, it was found that traditional transfer pricing methods attach great importance to the comparability of products and transactions made between companies and to the existence of uncontrolled transactions, transactions made between the tested(tax paying) party and an independent company. At the same time, transactional methods use the comparability of functions and activities performed by comparable companies. Besides, the profit split method requires that the both of the parties involved into transfer pricing contribute to the activity that is priced. Furthermore, it was revealed during the in-depth interview, that LBBV has two main activities: bunkering, which is not profitable and operational and logistical support of LITASCO's operations, the activity, in which LBBV makes profit. It is significant to note that LBBV provides the second service only to LITASCO. In the end, the calculation of the arm's length transfer prices under each transfer pricing method is shown and explained with the use of examples.

The chapter five focuses on conclusions and recommendations based on them. First, the conclusions that are made on the basis of the research findings are presented. Considering the answers to all the research questions together, it was concluded that the most optimal transfer pricing method for LBBV is the transactional margin method. Firstly, out of two main activities of LBBV, only the second one is a subject to pricing, since the first one is not profitable. Next, LBBV provides the operational and logistical support, which is the second activity, only to LITASCO, so that it can be inferred that LBBV is not involved in uncontrolled transactions. Hence, the traditional methods are not applicable. Taking into account that LBBV is the only responsible party for operational and logistical support and that LITASCO does not contribute to this service, the profit split method cannot be applied. Hence, the only applicable method is transactional net margin method. Further, the recommendation, which deals with the estimation of the arm's length transfer price under the chosen transfer pricing method is provided.

The last chapter focuses on the implementation of the recommendations. In order to apply the transfer pricing LBBV need to amend the service agreement with LITASCO and contact the Dutch Tax Authority in order to let it know about the use of transfer pricing.

Chapter 1. Introduction

Introduction to company

LITASCO GROUP chart.

The headquarters of LITASCO Group, the exclusive international marketing and trading company of LUKOIL Group is situated in Geneva, Switzerland. The company mainly trades crude, products and petrochemicals in Europe, CIS, Mediterranean, North and West Africa. The LITASCO has 10 subsidiaries and affiliates, which are spread over the world. These offices are mainly engaged in oil trading in the regions of location.

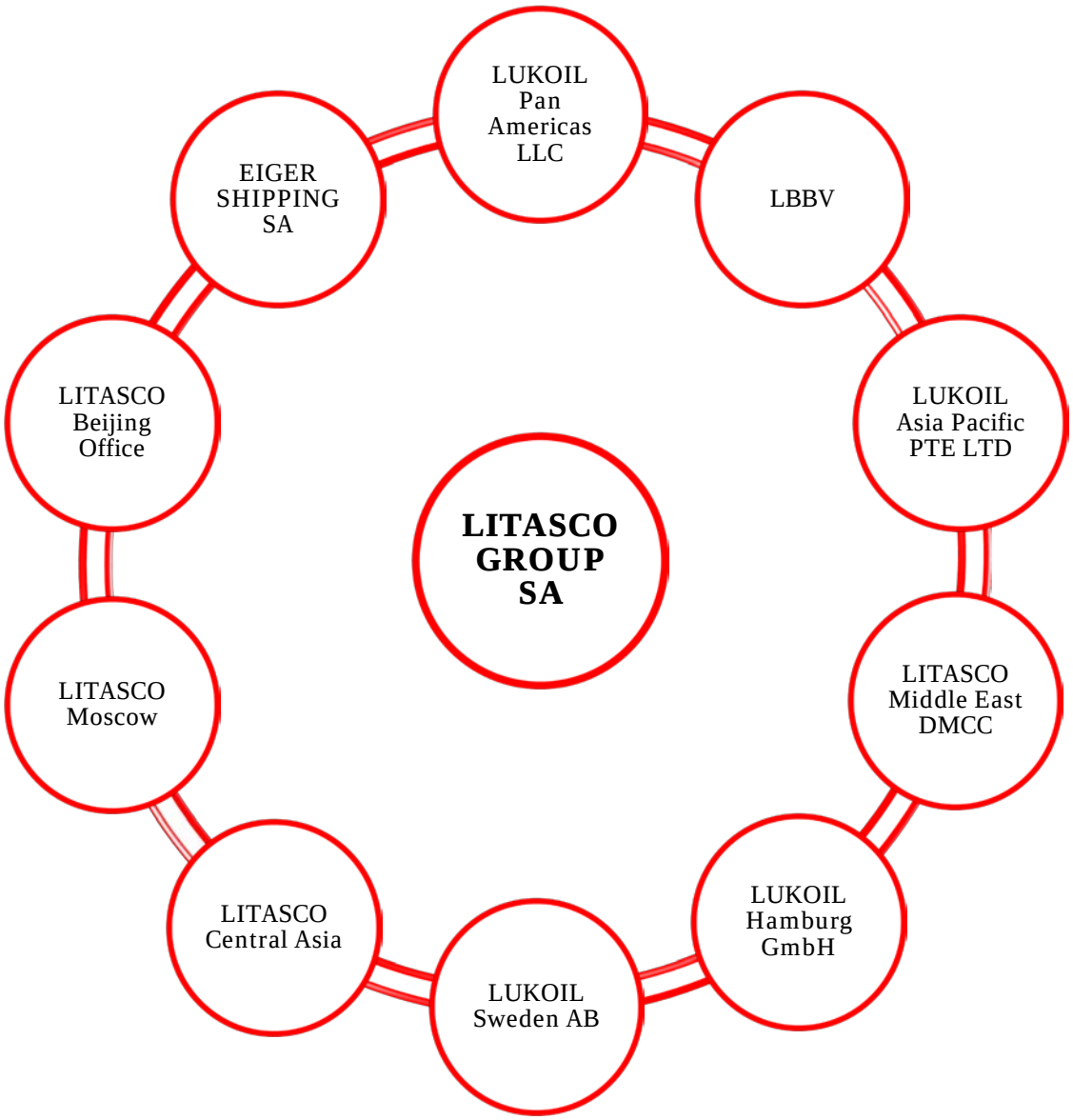


Figure 1LITASCO GROUP

LBBV

LBBV was established in 2001 and has been a subsidiary of the main company of the LITASCO Group called LITASCO SA ("LITASCO"). Situated in Rotterdam, the biggest port of Europe, LBBV mainly provides supporting activities for the parent company LITASCO, which is located in Geneva, Switzerland. The company is also a reliable physical supplier of bunker fuels in ARA region ("Amsterdam-Rotterdam-Antwerp"). The LBBV has a stable client base that includes globally recognized large and medium shipping lines, as well as the other trading companies. The target market of the company is large and medium-sized shipping lines as well as other trading companies that deal with bunker operations. Rotterdam is by far the largest market, followed by Antwerp and Amsterdam. LBBV is among the top 6 in the market of bunker fuels in ARA. The market share of LBBV has been between 5 and 10% in the last 5 years. After experiencing a decline of the market share in 2008-2009 due to a crisis, the company enjoyed a certain growth in 2010 and 2011. However, in the following year the share of the company fell again because of a more cautious position due to the negotiations about issues related to waste, debunkering and quality.

Main activities

The LBBV's core activities are the following:

physical supplies of bunker fuels and bunker trade (back-to-back trade in bunker fuels and gasoils) in ARA

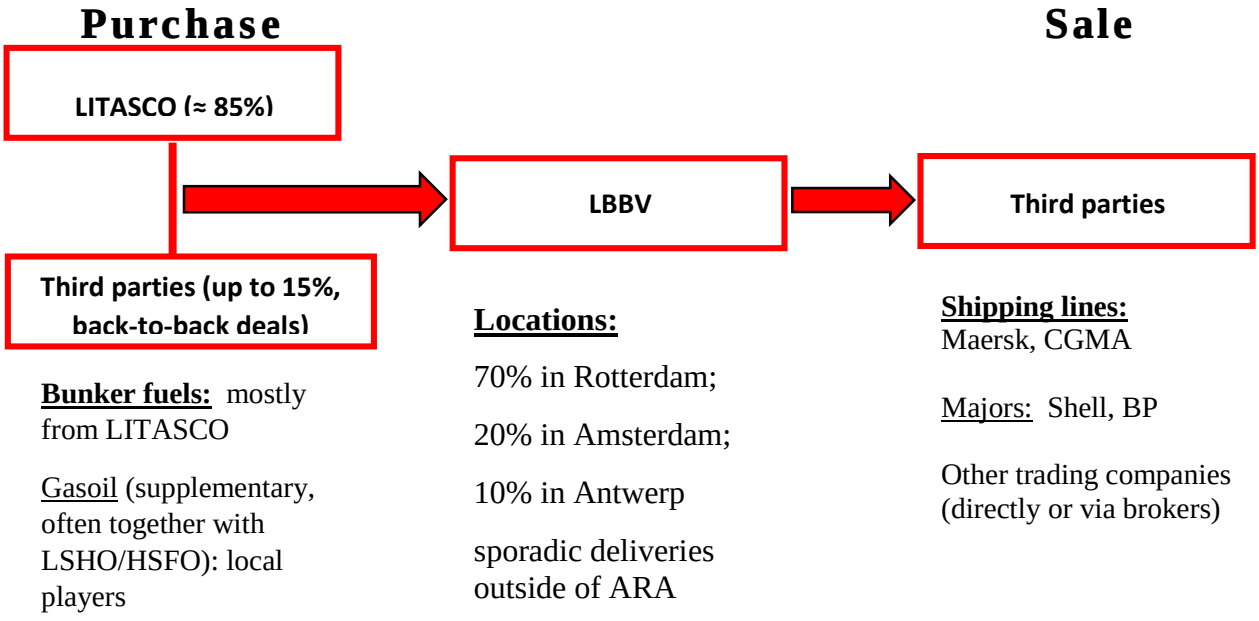


Figure 2LITASCO and LBBV operations 1

LBBV purchases almost all amount of bunker fuels from its parent company LITASCO. The rest amount of bunker fuels and gasoil, normally making up to 15% of the total volume, is purchased from third parties for the back-to-back deals. These deals pose no price-related risks. As a bunker trader, the company sells bunker products to a wide range of and trading companies in and outside ARA, including several small Dutch and Belgian ports. LBBV is also presented in

other European and world's ports as a trader arranging delivery of bunker fuels and bunker gasoil to the shipping lines through the local physical suppliers. The products traded by the Company are intermediate fuel oils with high and low content of sulfur.

The second main activity that LBBV executes is the operational and logistical support for LITASCO's trade of oil products on barges in the ARA.

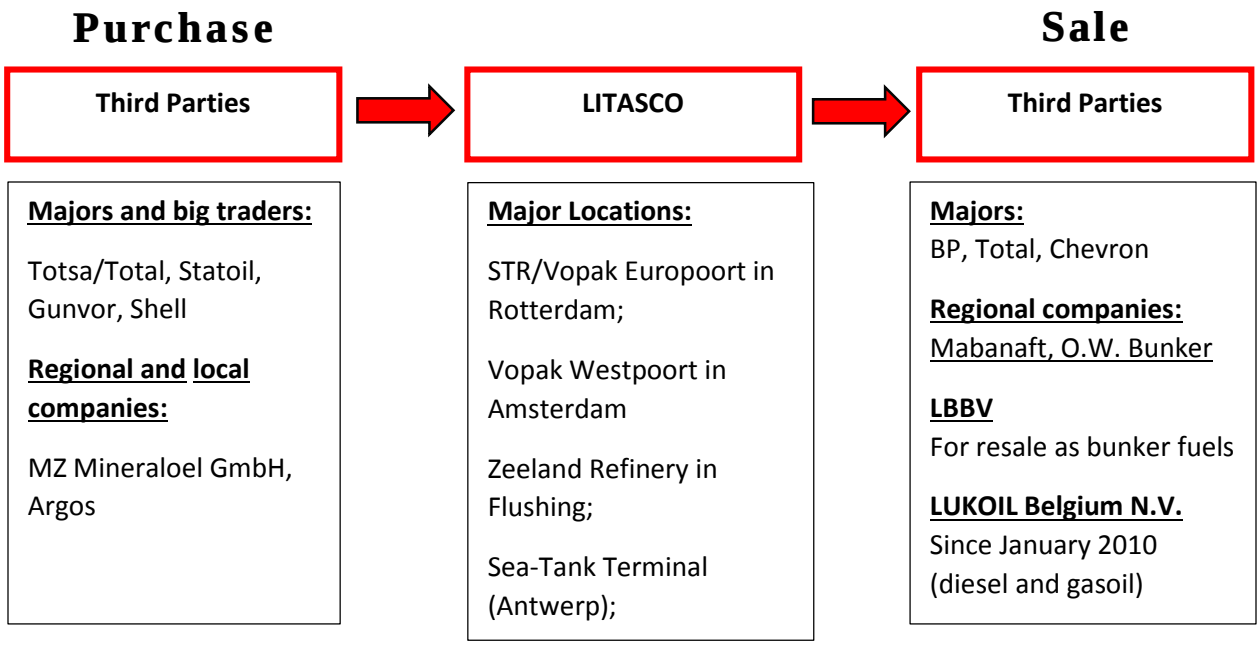


Figure 3LITASCO and LBBV operations 2

The support for LITASCO mainly concerns the covering of LITASCO's activities around Service Terminal Rotterdam and Vopak Europoort in Rotterdam, Zeeland Refinery in Flushing, , Vopak Westpoort in Amsterdam and Sea-Tank Terminal/Sea-Tank 510 in Antwerp. Since the second quarter of 2012, LBBV has expanded its operational activities and has been covering LITASCO Group's Spanish operations around the Meroil terminal in Barcelona, in which LITASCO is one of the owning partners. LITASCO trades in a wide range of oil products such as fuel oils, cutterstock, middle distillates (gasoil and gasoline), jet, naphtha, LPG. The products that the company trades in vary from a location to a location.

Management issue

As a consequence of globalization, an increasing number of corporations place their activities across different countries. The world of business has undergone a substantial transformation in the past decades, so that multinational firm activity has become an inevitable part of the global economy. Multinational enterprises ("MNE") are highly important for the world of business and account for a major share of economic activity around the world. The impact of MNEs on today's economy is so huge that some of the companies even have resources and power similar to those of a middle-income country. Such enterprises are on public eye due to the fact that they are not only big, but also highly productive and profitable. The MNEs considerably improve the economy of the country in which they are located, since they create employment, investments and more importantly enable the governments to generate tax revenue by making substantial profit. At the same time, there are widespread concerns that due to their international exposure, the MNEs can avoid taxation in high-tax jurisdictions. One of the commonly known ways to do so is the application of transfer pricing on transactions between company's divisions.

In general, intercompany transactions enable MNEs to shift income from one jurisdiction to the other. The profit shifting presents risk to governments since this process may lead to reduction of tax revenues. As a result, an increasing number of governments introduce and extend transfer pricing regulations in order to challenge profit shifting through intercompany transactions. Transfer pricing is the pricing of goods, services and technology transferred to a foreign subsidiary from an affiliate company. The Organization for Economic Co-operation and Development (OECD) has adopted the extension to the Article 9 OECD, which comprises the arm's length principle, a first report on the transfer pricing. The arm's length principle states that the prices between the entities of a group have to be that same as they would have been if the parties of transaction had not been related to each other. This principle bars companies from setting their own internal rules without the external invasion. The OECD guidelines allow companies to employ one of five offered methods of transfer pricing. The corporate income tax rate in Geneva, where the parent company of LBBV is located, is much lower compared to the Dutch 25%. In order to minimize the taxable income, pay less taxes and thus increase the net income, LBBV needs to employ method that will enable it to do so, with regard to the taxing rules and regulations set by Dutch Tax Authority.

Thesis objective.

The objective of the thesis is to "define an optimal transfer pricing method for LBBV, a subsidiary of LITASCO", with regard to the taxing rules and regulations set by Dutch Tax Authority.

There are five transfer pricing methods:

1. Comparable Uncontrolled Price Method (CUP)
2. Resale Price Method (RPM)
3. Cost Plus Method (CPM)
4. Transactional Net Margin Method (TNMM)
5. Profit Split Method (PSM)

Each method is calculated differently from another as it takes into account different pricing factors and variables. The term "optimal' in the current research will be determined with regard to the following criteria:

Applicability of the method

Each method has its specifics and cannot be applied to each case. Hence, in order to assure optimality, the method has to be applicable to the particular case of LBBV.

Transfer price

The other criterion that will determine the suitability of the chosen transfer pricing method is taxable income that will be generated by LBBV after application of each transfer pricing method. The profit amount has to be as least as possible in the Netherlands, with regard to the rules and regulations posed by Dutch Tax Authority. This will enable LBBV to cut the tax outlays, thus increasing the profit of its parent company, LITASCO, which is located in Switzerland.

Main research question

The main question that has to be answered upon completion of the research is "What is an optimal transfer pricing method for LBBV, a subsidiary of LITASCO, with regard to the taxing rules and regulations set by Dutch Tax Authority?"

Research questions

In order to reach the thesis objective it is essential to delve deeply into the area of transfer pricing. It is important to gain information from the perspectives of both LBBV and the government of the Netherlands, since both positions need to be taken into consideration. A wide range of questions and amount of various data have to be encountered to make a reasonable inference. The answers to the research questions will help get into the picture of the research topic gradually and develop the understanding accordingly.

The main question that the research aims to answer is "What is an optimal transfer pricing method for LBBV, a subsidiary of LITASCO, with regard to the taxing rules and regulations set by Dutch Tax Authority?"

The following questions need to be answered in order to obtain valid and sufficient information concerning transfer pricing methods and thus make steps towards providing solutions to the main research question.

1. What transfer pricing methods exist?
2. What are the advantages and disadvantages of each transfer pricing method?
3. What are the rules regarding the transfer pricing in the Netherlands?
4. What are the main activities of LBBV?
5. How to apply the arm's length price under each transfer pricing method?

The first question deals with the transfer pricing methods. It is crucial to be familiar with various methods in order to gain initial knowledge about transfer pricing and build a foundation, on which the future research will be based.

The next question focuses on the advantages and disadvantages of each method. The choice of method heavily depends on its peculiarities and specifics, so that the knowledge of factors that distinguish one method from another is significant.

There is no doubt that external factors have a huge impact on the businesses, their performance and operations. The rules and regulations regarding the transfer pricing differ from country to country. Taking into account that LBBV is situated in the Netherlands, the principles of transfer pricing in this country have to be found out.

The internal factors are of great importance when it comes to defining an optimal transfer pricing method. The services between LBBV and LITASCO, its parent company, have to be extensively researched. The activities that LBBV provides on behalf of LITASCO and their value may be a defining factor.

The final and most important step towards achieving the thesis objective is the application of transfer pricing methods that are commensurate with the specifics of services between LBBV and LITASCO. The transfer pricing method that will result in the least earnings before tax and at the same time comply with the arm's length principle will be chosen with regard to transfer pricing regulations in the Netherlands. The least amount of earnings before tax will enable LBBV to allocate bigger earnings to LITASCO and outlay less tax payments in the Netherlands.

Research objectives

Research objectives have to be identified in order to answer the research questions and therefore achieve intermediate results that will help define the most beneficial transfer pricing method for LBBV. Hence, the following research objectives that stem from research questions have been designed:

1. identify what transfer pricing methods exist
2. observe relative strengths and weaknesses of each transfer pricing method
3. find out the rules and regulations imposed by the Netherlands, regarding the applicability of transfer pricing
4. determine the main activities of LBBV
5. apply the arm's length price under each transfer pricing method

Ishikawa diagram

The diagram provides an illustration of the steps and measures that have to be taken in order to achieve the thesis objective. The steps are derived from the research objectives, which are vitally important in reaching the overall purpose of the research.

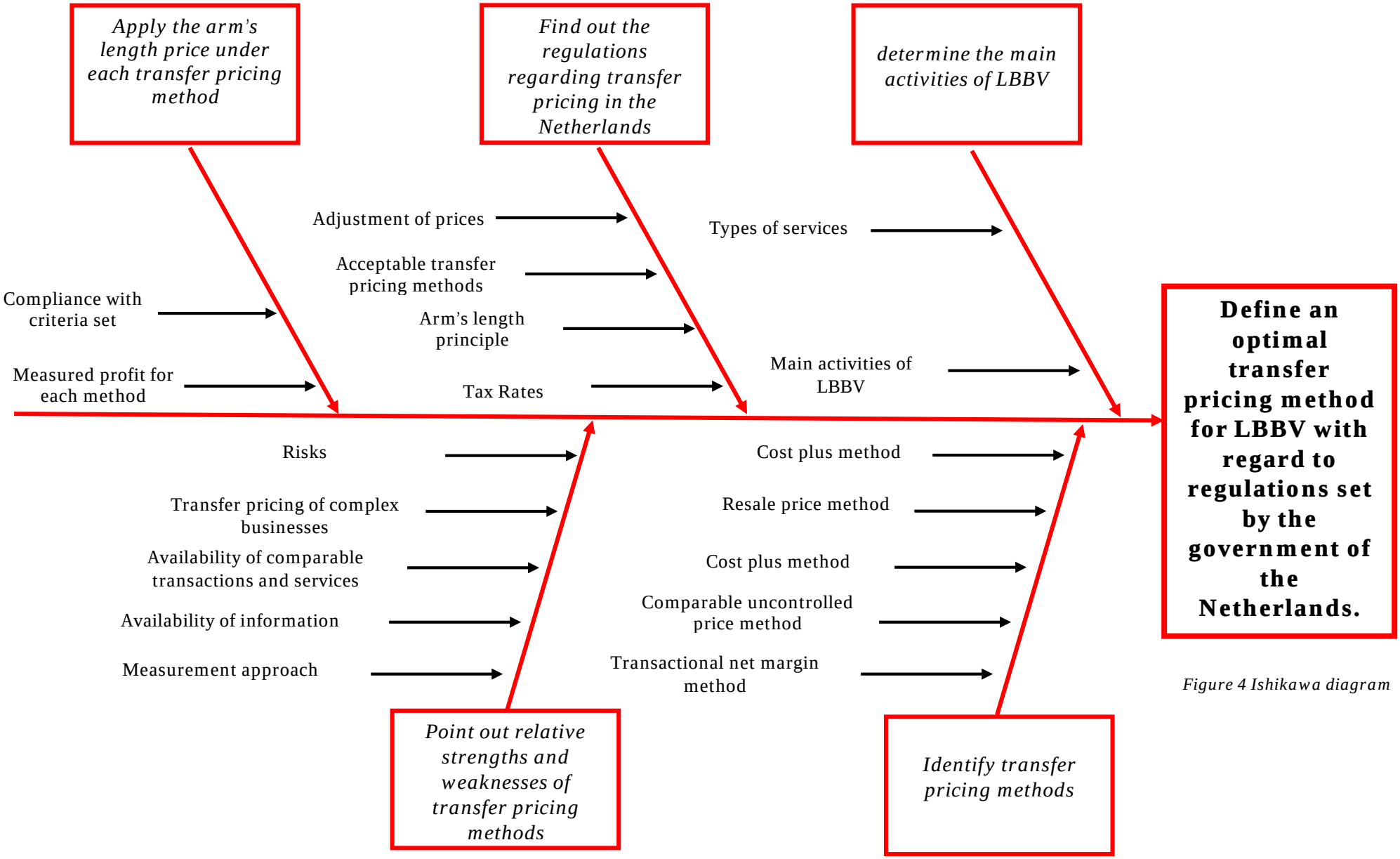


Figure 4 Ishikawa diagram

Introduction to next chapter

The next chapter provides an insight into the theory and approaches that exist towards transfer pricing and its applicability in The Netherlands. The literature outlines a critical discussion and summary of the literature of high relevance to the area of transfer pricing. The information contained in this chapter is derived from a wide range of secondary sources such as company books and publications and presentations issued by leading auditing firms.

Chapter 2. Theoretical foundation

Introduction

The chapter focuses on the literature that can provide an insight into the research area. The books, works and articles that capture the elements, types and specifics of transfer pricing will serve as initial knowledge, on which the further research will be based. The chapter describes the primary and secondary sources that provide information that is helpful in obtaining data that can be used as a basis in answering the research questions.

The chapter begins with a brief description of techniques that can be used in order to minimize the tax payments. Further, the literature exploring the transfer pricing methods and their relative strengths and weaknesses is described. Moreover, the rules and regulations along with examples of how to calculate each transfer pricing method are set out.

Finally, the chapter ends with a relevance tree that structurally illustrates interrelations between the literature and the research questions.

List of definitions

Transfer pricing - the pricing of goods, services and technology transferred to a foreign subsidiary from an affiliate company

Net profit margin – a profit before taxation

Controlled transaction – a transaction, in which the parties involved are affiliated

Uncontrolled transaction – a transaction, in which the parties involved are not affiliated and are themselves not part of a group.

Comparable companies - companies that perform activities similar to those performed by the tested party.

Direct cost – a price that can be completely attributed to the production of specific goods or services.

Gross margin - the percent of total sales revenue that the company retains after incurring the direct costs associated with producing the goods and services sold by a company

Traditional transfer pricing methods – the methods that focus on the comparability of transactions made between companies

Transactional transfer pricing methods – the methods that concentrate on the comparability of functions performed by companies

Tax minimization techniques

The report called *"The increasing importance of transfer pricing regulations - worldwide overview"* by *Lohse, Riedel and Spengel* (Lohse, Riedel, & Spengel, 2012) emphasizes the methods that can be employed by multinational corporations in order to minimize the taxable income and, hence, the taxes. The report divides the tax minimization techniques into permanent and temporary. Temporary tax savings can only defer the payments to a later point in time, while the permanent tax savings will not change and they are useful in case the tax paying company identifies transferable profit.

The book "*Multinational Business Finance*" (Eiteman, Stonehill, & Moffett) takes another approach to classification of tax minimization techniques and points out two possible ways of tax minimization in a long-run. The methods are business restructuring or shifting of capital and shifting of income. According to the book, the shifting of capital was used in the past and it is very complex to do offshoring. At the same time, income can be shifted in multiple ways, namely by intercompany financing, a centralization of responsibilities and adjustment of prices of intercompany services. All these methods can be used, as the tax systems consider corporations as separate entities and allow for the deduction of costs in one jurisdiction and receipt of funds in another jurisdiction.

Transfer pricing

The following section provides information about the literature that is explored in order to obtain information about transfer pricing. The information derived from the secondary sources focusing on transfer pricing will be helpful in answering the first part of the first research question, which is as follows: "What is transfer pricing?"

Seal, Garrison and Noreen in their book called "*Management Accounting*" (Seal, Garrison, & Noreen, 2009) give definition of transfer pricing. Transfer pricing is a price at which the entities of the group transact with each other. Transfer prices do not usually differ a lot from that in the market because one of the entities in such a transaction will be worse off

Since transfer prices may increase the performance one of the entities and decrease that of the other, there have to be specific conditions under which transfer pricing can be applied.

"*Transfer Pricing in Multinational Corporations*" (Hiemann & Reichelstein, 2012) specifies the conditions under which the transfer pricing has to be used and when it is beneficial for the company. The books concentrate on such factor as the behavior of divisional managers when it comes to transfer pricing. The main factor that has to be ensured is that there is not a divergence of interests between managers of the divisions that are engaged in transfer pricing, so that they act in the best interest of the whole company.

Transfer pricing methods

The *OECD (Organization for Economic Co-operation and Development) guidelines* (Transfer Prices, Application of the Arm's Length Principle and the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines"), 2001) together with "*Transfer pricing handbook*" (Feinschreiber & Kent, Transfer pricing handbook: guidance for the OECD regulations, 2012) describe the transfer pricing methods that are compliant with the arm's length principle. The considered five methods are divided into two groups: transactional and traditional. Traditional transfer pricing methods – the methods that focus on the comparability of transactions made between companies. They include comparable uncontrolled price method, resale price method and cost plus method. Transactional transfer pricing methods – the methods that concentrate on the comparability of functions performed by companies

They comprise profit split method and transactional net margin method. The report issued by OECD specifies what factors each transfer pricing method takes into account when establishing the arm's length price and under which conditions each of transfer pricing methods can be applied. Moreover, the comparison of cost plus method and transactional net margin method, methods that use similar techniques in establishing a transfer price, is provided. What is more, the report introduces terms such as controlled transaction, uncontrolled transaction, traditional and transactional transfer pricing methods, comparability of companies, transactional comparison and functional comparison.

The exploration of the aforementioned literature will help provide the answer to the first research question "What transfer pricing methods exist?"

Relative strengths and weaknesses of each transfer pricing method

The following chapter focuses on the literature that provides information about relative strengths and weaknesses of each transfer pricing method.

Firstly, *Feinschreiber in his work "Transfer pricing guide"* (Feinschreiber, Transfer pricing guide, 2004) points out the strengths and weaknesses of each transfer pricing method from the point of its applicability. The book concentrates on the factors that have to be ensured in the method to be applicable. For example, it states that traditional methods attach importance to the comparability of transactions. However, it is highly difficult to find information about comparable transactions and their specifics. What is more, traditional methods require that the tested (tax-paying) party is involved in controlled transactions. The above-mentioned book uses such terms as controlled transaction, uncontrolled transaction, comparability of services and products, comparable information, availability of information in order to explain why the particular method cannot be used in particular situation.

However, it was also important to get to know what transfer pricing methods are used to price particular services.

"Transfer Pricing for Multinational Companies" (Wintzer, 2007) has taken different approach towards the definition of the relative strengths of the transfer pricing methods. The study mainly concentrates on types of products, services and operations to which a particular transfer pricing method is more suitable. For instance, it is advised to use cost plus method to price semi-finished products or services. The resale price method is usually applied to marketing activities.

All in all, the two above-mentioned secondary sources provide information that is highly important for answering the second research question which is: "What are the relative strengths and weaknesses of each transfer pricing method?"

Regulations related to transfer pricing in the Netherlands

The chapter focuses on the literature that sets out information about regulations set by Dutch government body responsible for taxing rules and regulations.

Firstly, the *"Global Transfer Pricing Review"* published by KPMG (KPMG, 2012) concentrates on the rules and regulations of Dutch tax system regarding transfer pricing and the public authority responsible for them. The study also provides information about how the tested party has to justify the choice of the transfer pricing method and which transfer pricing method are

allowed to be used in the Netherlands. It is stated that all the five transfer pricing methods are allowed to be used in the Netherlands if the choice of the method is reasonably justified.

The "International Transfer Pricing *Book*" published by PWC (PricewaterhouseCoopers, 2013) centers on such crucial factor as the usefulness of comparable information, on which several transfer pricing methods are based. The study mentions the importance of comparable analysis and discusses different cases that may occur if the tested party does not conduct this analysis by itself.

The *"Funds Transfer Pricing"* published by Ernst&Young (Ernst&Young, 2013) accentuates on how the arm's length price has to be calculated and considers various cases. What is more, it pays specific attention to the Dutch legislation, namely what position the taxing body will take when judging the estimated arm's length transfer price.

The *"Global Transfer Pricing Guide"* issued by Deloitte (Deloitte, 2014) focuses on the use of multiple year data when determining the range of transfer prices. What is more, it describes the actions that should be taken once the range is established and considers various possible cases.

The information outlined in the aforementioned literature is helpful in providing the answer to the following research question: "What are the rules regarding the transfer pricing in the Netherlands?"

Application of the arm's length transfer price

The issues related to the application of the transfer pricing methods and estimation of the arm's length transfer price under each of them are considered in this part of the chapter.

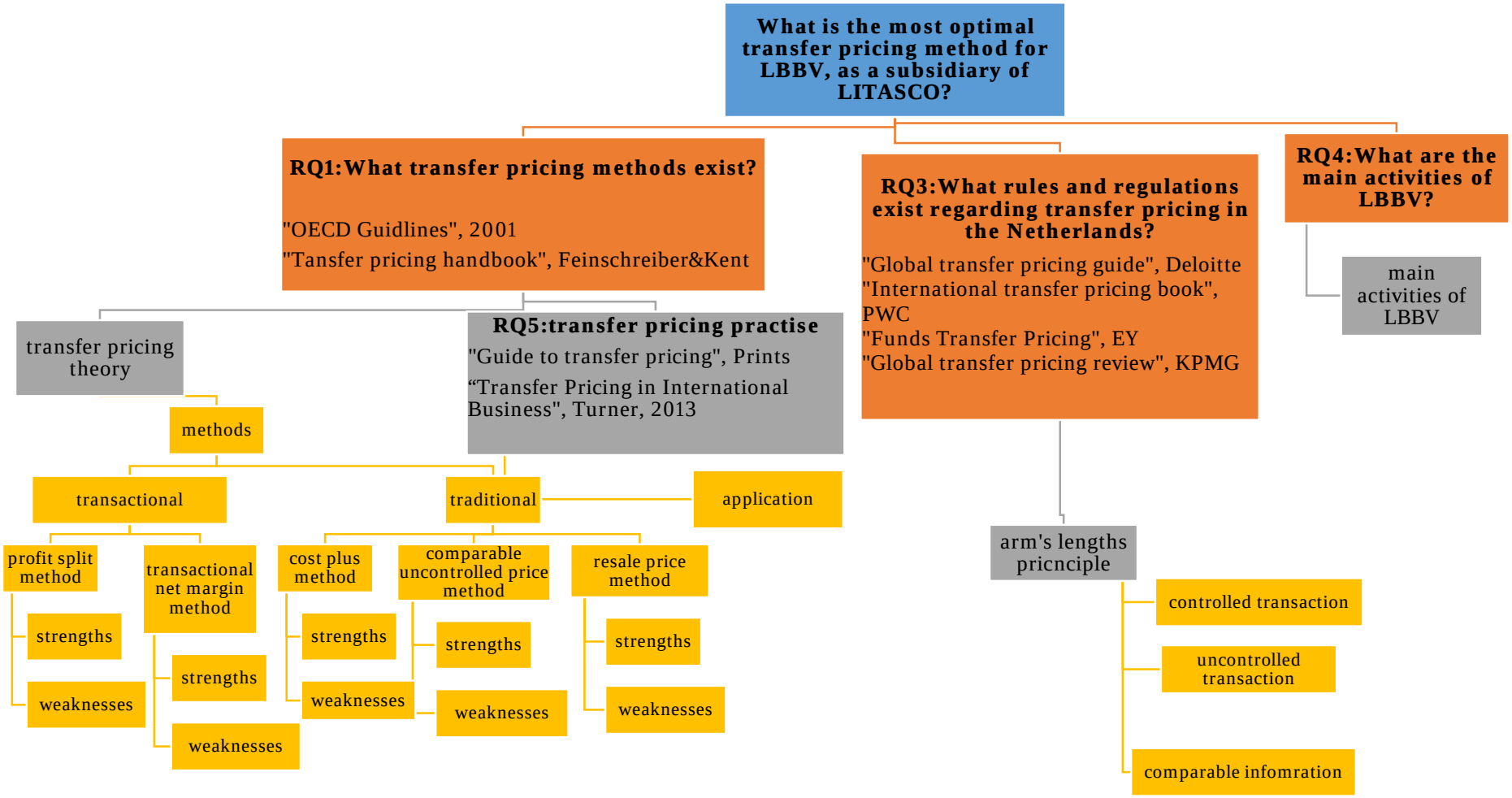
The book *"Guide to transfer pricing"* (Prints, 2013) published with a participation of *OECD* and "*Transfer Pricing in International Business: A Management Tool for Adding Value*" (Turner, 2013) provide examples of how the arm's length price under each transfer pricing method is calculated. In order to make the understanding of calculations easier and compare the transfer pricing methods the book applies the methods to the same cases. During the process of calculation such terms as controlled transaction, uncontrolled transaction, net profit margin, cost plus mark-up, direct costs and indirect costs are mentioned in the book.

"Transfer pricing for multinational companies" (Wintzer, 2007) provides the comparison of transactional net margin method and cost plus method applying both of the methods to the same case. The comparison helps to understand the difference between the methods in spite of the fact that the calculation techniques are similar between them. The only difference is that cost plus method uses the gross profit margin, while transactional net margin method relies on the net profit margin.

The exploration of the information presented in the above-stated literature is important in answering the research question, which is as follows: "How apply the arm's length price under each transfer pricing method?

Relevance tree

Relevance tree is a tool, which allows to present ideas over a certain topic in a structured manner. The following relevance tree provides an overview of the terms and principles involved in transfer pricing.



Summary

To conclude, the sources from which the answers to all the research questions related to the theory of transfer pricing and regulations in the Netherlands can be derived are given in the chapter.

Firstly, the literature that introduces the transfer pricing and shows from where the transfer pricing stem is outlined in the chapter. What is more, the next sources focus on the definition of transfer pricing and conditions in which transfer pricing can be employed. Finally, the sources that provide description of each transfer pricing method are set out.

Secondly, the literature that points out the relative strengths and weaknesses of each transfer pricing method is described.

Thirdly, the sources that describe the rules and regulations about transfer pricing that exist in the Netherlands are provided. The sources focus on responsibilities of the company and the government body when using transfer pricing.

Finally, the sources that provide examples of how the arm's length transfer price has to be calculated under each transfer pricing method are set out. .

Introduction to next chapter

The next chapter concentrates on research design, namely the general plan according to which the research questions will be approached. It specifies the sources from which the data is collected, emphasizes its relevance and validity and points out the constraints that can be faced in the process of the research. What is more, it explains what research strategy is employed in the research and provides a relevant justification for the chosen strategy.

Chapter 3. Research methodology

Introduction

The chapter provides a full insight into research methods and strategies that are used in order to obtain relevant, reliable and valid information to build a solid knowledge basis to make reasonable assumptions. Firstly, the section focuses on the research strategy that will be employed in this research and provides reasonable justification for the chosen strategy. The research strategy is one of the core elements of the research. The research objectives can be met only when the right research strategy is employed. The research strategies vary according to the needs and specifics of the researcher and the topic. The choice of research strategy depends on the research questions and objectives, the extent of existing knowledge, the amount of time and availability of other resources. Moreover, a great importance was attached to the analysis of the units such as LBBV, LITASCO in order to understand the nature of the businesses between them that can be related to transfer pricing.

Research questions

In order to reach the thesis objective it is essential to delve deeply into the area of transfer pricing. It is essential to gain information from the perspectives of both LBBV and the government of the Netherlands, since both parties have to be considered for decision-making. A wide range of questions and various data have to be encountered to make a reasonable inference.

The main question that the research aims to answer is "What is an optimal transfer pricing method for LBBV, a subsidiary of LITASCO, with regard to the taxing rules and regulations set by Dutch Tax Authority?"

The following questions need to be answered in order to obtain valid and sufficient information concerning transfer pricing methods and thus make steps towards providing solutions to the main research question.

1. What transfer pricing methods exist?
2. What are the relative strength and weaknesses of each transfer pricing method?
3. What are the rules regarding the transfer pricing in the Netherlands?
4. What are the main activities of LBBV?
5. How to apply the arm's length transfer price under each transfer pricing method?

Each research question is aimed at deriving relevant data about transfer pricing and its implementation in the Netherlands with regard to the taxing rules and regulation set by Dutch Tax Authority. What is more, research questions attach great importance to obtaining information about companies, namely the business relations between them to which transfer pricing methods can be applied.

The first question deals with the transfer pricing methods. It is crucial to be familiar with various methods in order to gain initial knowledge about transfer pricing and build a foundation, on which the future research will be based. The use of secondary sources of information such as books and articles on transfer pricing will help gather relevant data and give a comprehensive answer to this question.

The next question focuses on the relative strengths and weaknesses of each method. The choice of method heavily depends on its peculiarities and specifics, so that the knowledge of factors

that distinguish one method from another is significant. OECD guidelines, which are considered as a primary source of information, explicitly state the strengths and weaknesses of each method.

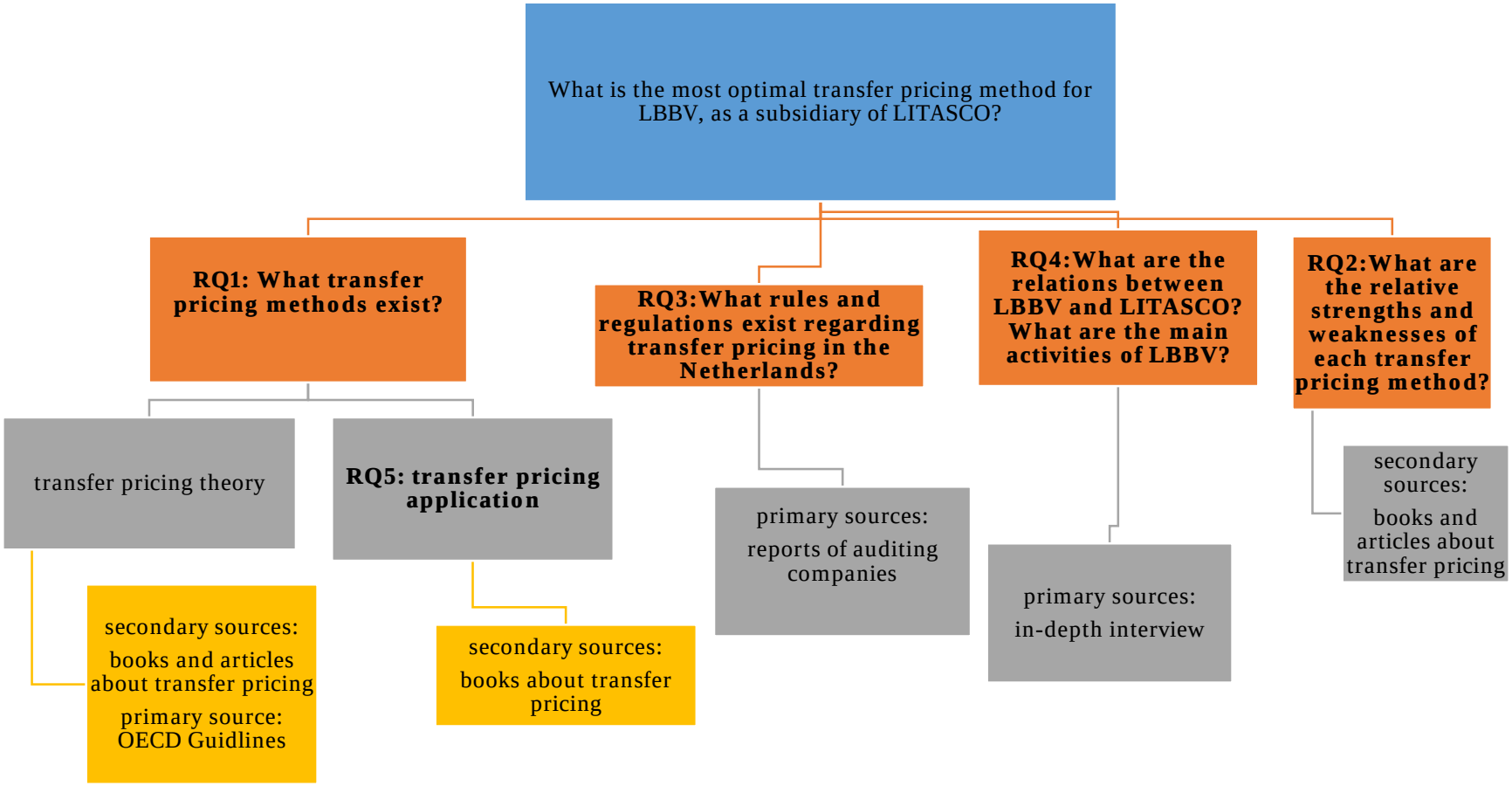
There is no doubt that external factors have a huge impact on the businesses, their performance and operations. The rules and regulations regarding the transfer pricing differ from country to country. Taking into account that LBBV is situated in the Netherlands, the principles of transfer pricing in this country have to be closely observed. The answer to these two questions can be provided with the use of such primary sources as articles and reports issued by leading auditing firms. These publications focus on the specifics of transfer pricing in the Netherlands, namely the methods that can be used and the degree of preference among them.

The internal factors are of great importance when it comes to defining an optimal transfer pricing method. The relations between LBBV and LITASCO, its parent company, have to be extensively researched. In order to obtain data about LBBV and LITASCO, an in-depth interview with the Acting Managing Director will be conducted. The questions that will be asked will concern not only the general information about LBBV, but also the main activities of the company and their profitability.

The final and most important step towards achieving the thesis objective is the application of transfer pricing methods that commensurate with the specifics of relations between LBBV and LITASCO. As soon as the most appropriate transfer pricing method is chosen with respect to the specifics of products and services between LBBV and LITASCO, the most optimal transfer price with regard to the taxing rules and regulations set by Dutch Tax Authority will be calculated. In order to gain general understanding of how the arm's length transfer price is calculated under each transfer pricing method the examples derived from secondary sources will be set out.

Relevance tree

The relvance tree provides infromation about which sources of information were used in order to obtain inforamtion that is sufficient to ansfer research questions.



Research strategy

As a result of careful consideration of all the research strategies, the “case study” approach has been taken. “Case study” is strategy for doing research, which involves an empirical investigation of a particular contemporary phenomenon within its real life context using various sources of evidence. (Saunders, Lewis, & Thornhill, 2009).

The case study strategy is of particular interest since it helps gain an insight into the context of the research and understanding of the context of the research and the processes being performed, so that so that this approach can help obtain knowledge about both transfer pricing and its applicability to LBBV.

This approach attaches a great importance to the generation of answers to questions such as “why?”, “what?” and “how?”. In order to meet the research objectives, the answers to the research questions related to the methods of transfer pricing, their strength and weaknesses, their applicability, main activities of LBBV have to be answered. Taking into account that the “case study” approach has a considerable ability to provide answers to research questions, the choice of this strategy deems the most appropriate.

The “case study” strategy allows for the use of various data collection techniques. In the case of the current research, interview with the Acting Managing Director of LBBV will be carried out. It will help to obtain relevant information about LBBV and its activities, so that the information about the particular case to which transfer pricing will be applied will be obtained. Moreover, other type of primary sources of information such as reports issued by leading auditing companies and OECD guidelines will be used in order to collect necessary data about transfer pricing methods, the rules and regulations in the Netherlands about transfer pricing. In addition to this, secondary sources, such as books and articles will be used develop a thorough comprehension of transfer pricing, transfer pricing methods and their relative strengths and weaknesses.

Unit of analysis

The chapter focuses on LBBV, namely its activities and operations concerning transfer pricing. The main unit of analysis is provision of services and products between them, since they can be priced in accordance with five transfer pricing methods. An in-depth interview with the Acting Managing Director of LBBV will be conducted in order to obtain all the relevant information about LBBV and LITASCO because products and services between them are subject to transfer pricing.

Unit of observation

The unit of observation concentrates on the items that enable to obtain information about units of analysis, namely business relations between LBBV and LITASCO.

The documents that outline information about activities of LBBV and LITASCO are the annual reports and company books issued by the companies. These documents describe the business in which the companies operate and the degree of profitability of each business and activity.

Further, the list of comparables, namely companies performing activities similar to those performed by LBBV, with regard to price, terms of the service, risks involved and other criteria of comparability have to be observed in order to examine the applicability of transfer pricing methods.

Credibility of the research

Reliability

Reliability is a measure of the extent to which the data collection techniques are able to yield consistent findings. The information obtained in the process of the research is highly reliable, since it was derived from books and other secondary sources that are not subject to bias. What is more, the interview conducted with the managing director of the subsidiary, a person who has the highest authority in LBBV, provides a secure information about company, so that there is not a threat of employment insecurity, which occurs when interviewees say what their bosses want them to say.

Validity

Validity refers to whether the research findings are really about what they appear to be about. The data outlined in the research is highly relevant and applicable to the topic. It employs the secondary sources such publications of the researched companies and books issued by auditing firms, which are famous for the relevance and validity of the information that they outline.

Planning and execution

A big importance in the process of the research was attached to planning and time limitations set for each chapter of the thesis. The first chapter of the research took considerable amount of time to structure, since it was crucial to understand the topic, develop a concise objective of the thesis in order to plan further research questions and objectives and steps that will be made in order to achieve them.

The theoretical foundation part was less time-consuming as the main thesis and research objectives and questions were outlined. However, it was essential to find reliable and valid sources that are highly relevant to the topic of transfer pricing and that point out the relative strengths and weaknesses of each method. What is more, an extensive analysis of the regulations set by Dutch Tax Authority was needed in order to examine the applicability of existing transfer pricing methods.

The research methodology chapter is an inevitable part of the thesis since it shows how the process of obtaining relevant data is structured and designed. At the same time, it did not take a lot of time to describe this process, since the information sources from which the data had to be gathered were well-defined and structured in previous chapters.

Summary

All in all, the chapter outlines the research strategies and data collection techniques that are used in order to obtain information with regard to research questions and objectives. Firstly, the chapter sets out the research questions that were defined in previous sections and provides a brief description of the sources that are used in order to answer each question. Further, the chapter focuses on the research strategy and justifies the chosen method. Finally, the units that are analyzed and observed in the thesis are set out concerning services taking place between LBBV and LITASCO.

Introduction to the next chapter.

The next chapter outlines the findings that have been collected during the process of the research. The findings derived from secondary sources such as books about transfer pricing

methods set out information about transfer pricing, transfer pricing methods and their relative strengths and weaknesses. The primary sources of information such as an in-depth interview and reports issued by leading auditing companies have enabled to obtain information about LBBV, its activities and rules and regulations on transfer pricing in the Netherlands.

Chapter 4. Research findings

Introduction

The chapter provides the information that was collected and revealed in the process of the research with the use of various concepts and theories, thus providing answers to the research questions.

Firstly, the chapter introduces the transfer pricing, defines it and enlists the existing transfer pricing methods, the information that was revealed with the help of secondary sources.

Further, the chapter points out the relative strength and weaknesses of each transfer pricing method with relevance to the existing case.

More to that, the rules and regulations set by the body responsible for tax legislation are set out. What is more, the chapter presents the rules concerning the adjustment of prices when the arm's length price is to be calculated.

Moreover, the information about LBBV, namely its activities with LITASCO are set out. The information outlined was obtained through an in-depth interview with the Acting Managing Director of LBBV.

Finally, the arm's length price calculation techniques are provided in the chapter with the use of examples that are the same for each transfer pricing method.

Research justification

The set of sources that are used to obtain information is sufficient for providing answers to the research questions, which are as follows:

1. What transfer pricing methods exist?
2. What are the relative strength and weaknesses of each transfer pricing method?
3. What are the rules regarding the transfer pricing in the Netherlands?
4. What are the main activities of LBBV?
5. How to apply the arm's length transfer price under each transfer pricing method?

Firstly, the secondary sources are used in order to develop initial understanding of transfer pricing and transfer pricing methods and their relative strengths and weaknesses. Secondly, the primary sources such as reports and electronic books published by leading auditing firms provide up-to-date data on the current rules and regulations regarding transfer pricing in the Netherlands. What is more, an in-depth interview conducted with the Acting Managing Director of LBBV, has enabled to obtain information about LBBV and its activities.

There have not been indicated noticeable deviations from the research design proposed in the previous chapter. The units of analysis and units of observation have been useful in obtaining information about LBBV. The data collections techniques used for answering research questions have been employed as described in the research design.

All in all, a combination of data collection methods used in the current research has enabled to obtain sufficient data for making inferences on the basis of it.

Answer to Research question 1.

The section provides the answer to the research question 1, which focuses on the definition of transfer pricing and existing transfer pricing methods and which is as follows: "What is transfer pricing? What transfer pricing methods exist?"

Exploration and analysis of secondary and primary sources focusing solely on transfer pricing and transfer pricing methods has helped provide an answer to the research question 1. It is significant to understand each transfer pricing method in order to know which of the methods is applicable to the particular company with its particular activities.

The section starts with introduction of tax minimization techniques one of which is transfer pricing. The information has been obtained through the use of the following report: "*The increasing importance of transfer pricing regulations - worldwide overview*"

The reduction of taxes can be achieved through the realization of temporary and permanent tax savings. Temporary tax savings can only defer the payments to a later point in time, since this method allows companies to retain profits rather than distribute them, while the permanent tax savings will not change. At the same time, the permanent tax savings are vitally important for multinational companies and the companies seize the opportunity by identifying transferable profits. In general, there are two main ways to minimize the taxable income and, hence, the taxes in a long-run. First method deals with restructuring of the business, including the transferring of people, assets or of an entire plant to a lower tax jurisdiction. This strategy was widely employed in the past, when many corporations moved their back-office operations and production to low-cost countries, such as China and India without the loss of performance. While the first method concerns with the shifting of capital, the second alternative, which is less complex, includes the shifting of income to a jurisdiction with lower taxes that grant tax incentives. Income can be shifted in multiple ways, namely by intercompany financing, a centralization of responsibilities and adjustment of prices of intercompany services. All these methods can be used, as the tax systems consider corporations as separate entities and allow for the deduction of costs in one jurisdiction and receipt of funds in another jurisdiction. What is more, the tax systems encourage and allow for the contracts based solely on the desire to save taxes. The companies take advantage of the aforementioned rules and employ transfer pricing in order to minimize taxes.

Transfer price is the price charged when one division of a company provides goods or services to another division of the company. Managers are highly interested in the way the transfer prices are set, as they may have a drastic effect on the apparent profitability of the division. The main factor that has to be ensured is that there is not a divergence of interests between managers of the divisions that are engaged in transfer pricing, so that they act in the best interest of the whole company.

Transfer pricing methods

The *OECD (Organization for Economic Co-operation and Development) guidelines* point out the types of transfer pricing that are compliant with the arm's length principle and their peculiarities. There are five transfer pricing methods:

Comparable uncontrolled price method (CUP)

The comparable uncontrolled price method establishes the comparison between the price of an uncontrolled transaction and the price of a controlled transaction. If there is any difference between the two prices, this may imply that the terms of the commercial and financial relations

of the associated enterprises are not consistent with the arm's length principle, and that the price in the uncontrolled transaction may need to be changed for the price in the controlled transaction. An uncontrolled transaction indicates that the parties involved are not part of one group.

The OECD enlists several characteristics, which have to be comparable in order to ensure the applicability of the comparable uncontrolled transfer pricing method. These are product type, quality, availability, assets used, risks, terms of contract and economic circumstances, such as timing and market development. If the aforementioned variables are comparable, the comparable uncontrolled price method will generally be the most direct and most reliable way of measuring the transfer price, making it the preferred pricing method in such cases. However, in some cases, the comparable uncontrolled price method may not be applicable, e.g. if the market is not competitive enough to define the market price or if assets are so unique that it is not possible to identify a comparable transaction. This holds especially true for transactions that involve intangible assets as they are usually based on substantial negotiations and contract terms, so that bargaining power can in most cases not be analyzed.

The diagram below illustrates the working mechanism of comparable uncontrolled price method.

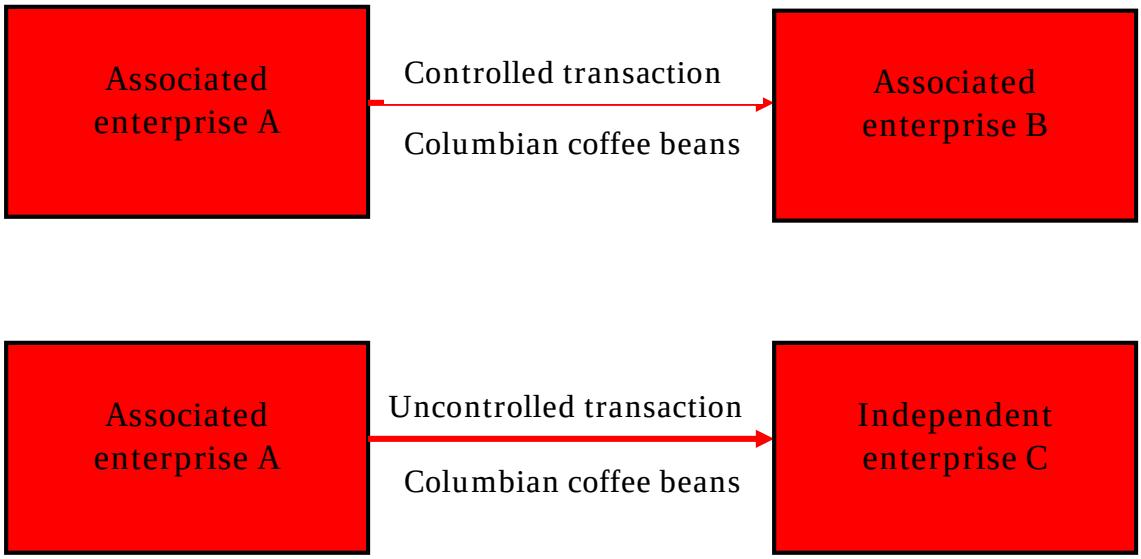


Figure 5 Comparable uncontrolled price method

Resale price method

The second traditional transaction method is the resale price method, the method under which the resale price obtained by a distributor is reduced by an appropriate gross margin in order to calculate an arm's length price. Thus, in a resale price method, the resale price margin (i.e. the gross margin) that the reseller earns from the controlled transaction is compared with the gross margin from comparable uncontrolled transactions. The appropriate gross margin can be found by observing and reviewing the transactions with independent companies. If there is not a case, the gross margin of similar products set by other distributors may be used. The gross margin consists of selling and other expenses arising from the functions performed, plus an appropriate profit margin. In general, the method is based on the assumption that all products have comparable gross margins, implying that products and terms of transaction have to be relatively similar. However, this statement is disputable and unconvincing, since it claims that, the gross

margins are equal across various firms, a claim, which does not seem realistic. Consequently, the OECD guidelines have taken into consideration this fact, so that if there are circumstances that increase the complexity of implementation of resale price method, adjustments have to be made.

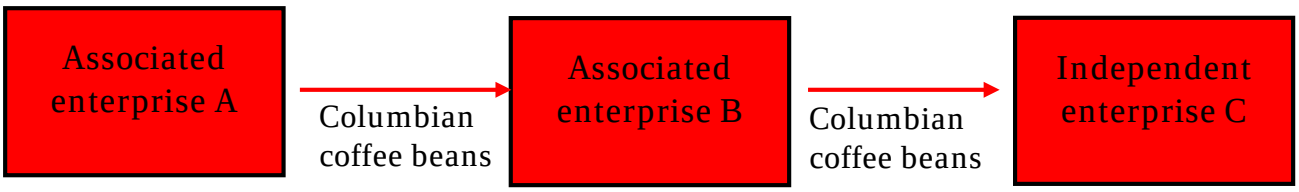


Figure 6 Resale price method

Cost plus method

It adds an appropriate cost plus mark up to the costs of goods sold to find an arm's length price. An appropriate cost plus mark-up is added to the direct and indirect costs allocated to a specific transaction with an associated enterprise – that is, to the cost basis – so as to make an appropriate profit in light of the functions performed. The mark- up is used to cover operating expenses. The method consequently begins with the gross profit margin. However, the same critique as to the resale price method can generally be addressed to the cost plus method in that whether cost plus mark ups are similar across different products and different firms and whether costs are even a rational starting point.

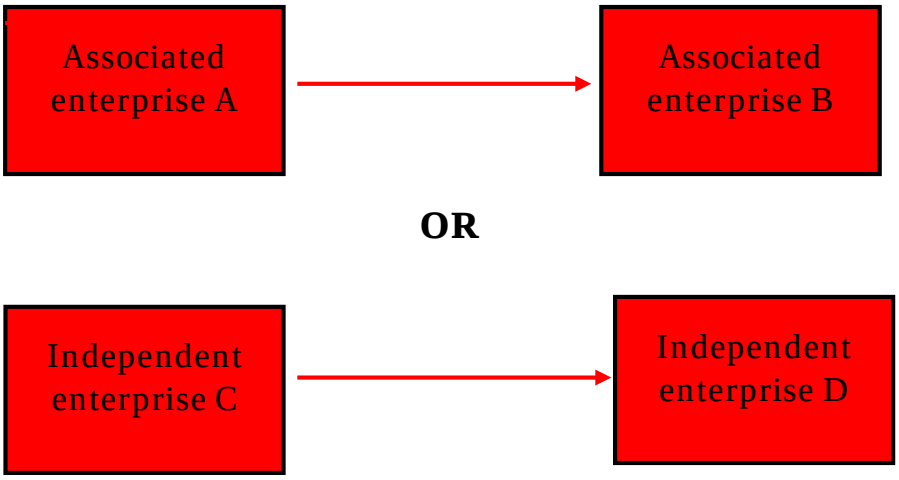


Figure 7 Cost plus method

Profit split method

The profit split method is classified as one of the transactional profit methods**.** It first identifies the profits earned by associated companies from collaborative activities. Then these profits are split according to relative share of each party's contribution. The profit split method attempts to eliminate the effect of a control relationship on profits belonged to each connected party by determining the division of profits that independent enterprises would have expected to generate from engaging in the tested transactions. Hence, the profit split method is therefore a 'two-sided' transfer pricing method. On the contrary, the other methods specifically recognized in the OECD Guidelines are 'one-sided' methods, which aim to price the appropriate return to one of the parties to a controlled transaction without necessarily any regard to the results of the other party.

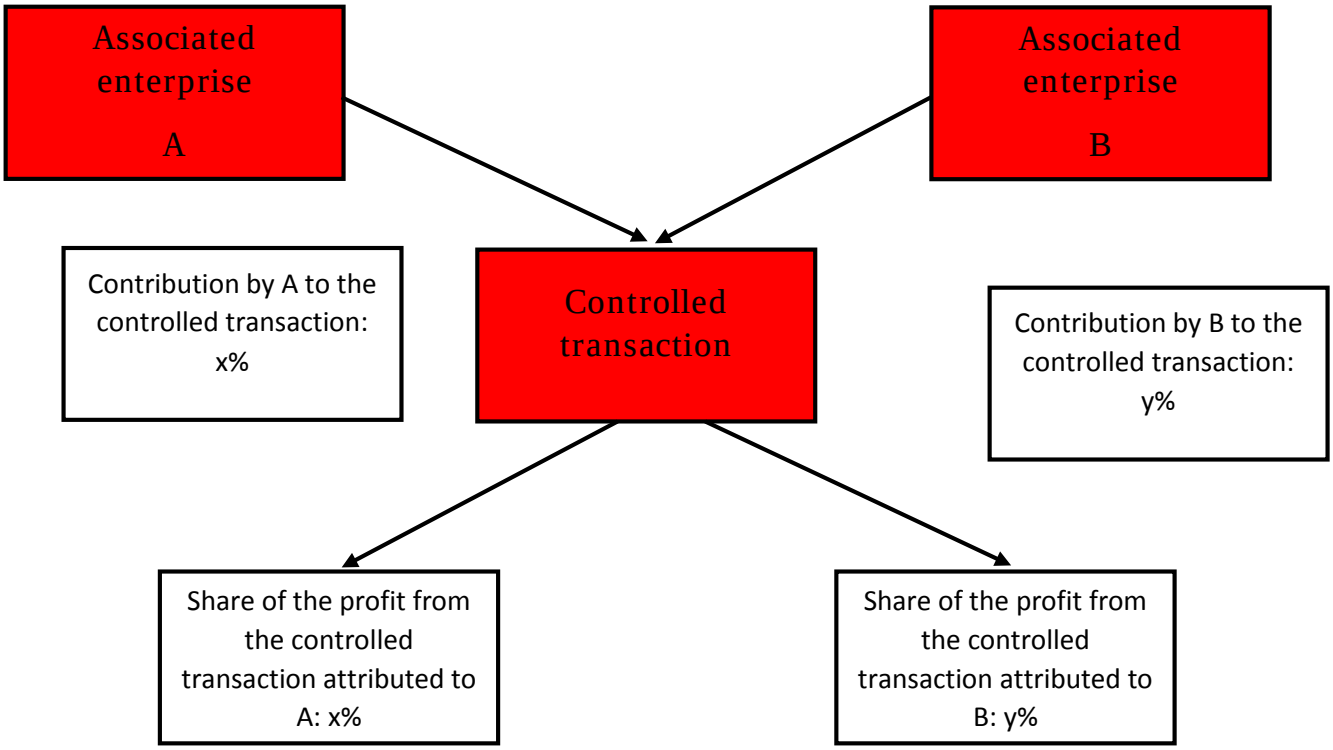


Figure 8 Profit split method

Transactional net margin method (TNMM)

The TNMM is also one of the transactional profit methods outlined in the OECD guidelines. The principle of this method is that the net profit margin (the profit before taxation, interest and extraordinary income and expenditure) relative to an appropriate basis (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction is compared with the net profit margin realized by similar standalone companies. The observed companies have to operate in the same business area, execute similar activities and manufacture or distribute comparable goods and services. A profit level indicator (PLI), such as operating profits to sales or gross operating expenses is calculated separately for each company. The advantage of this method is that information is more easily available and that the documentation effort is reduced compared to that of other methods. However, operating profits can be influenced by several factors, which are hard to identify and to estimate. Hence, the applicability of this method in compliance with the arm's length principle is often disputed.

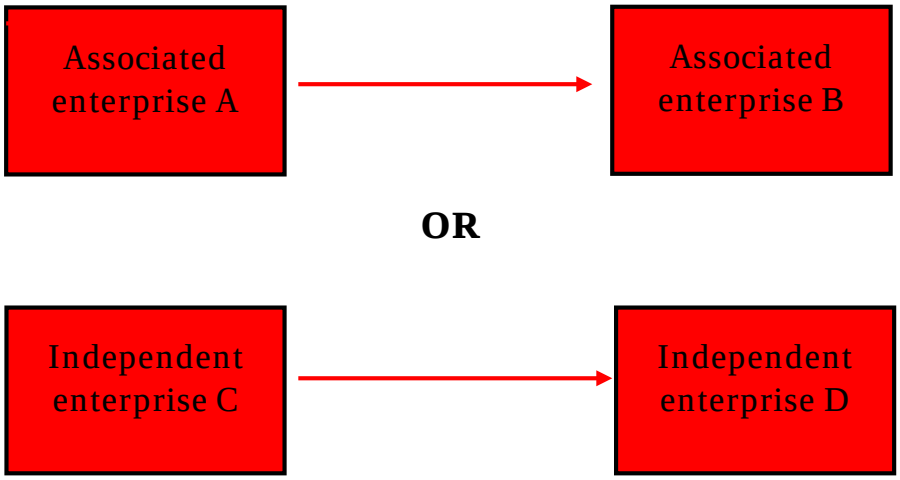


Figure 9 Transactional net margin method

Cost plus and transactional net margin methods

In spite of the fact that cost plus method and transactional net margin method belong to different groups, they use the same technique in determining the arm's price although using different ratios. Cost plus method uses gross profit margin while the transactional net margin method employs net profit margin.

The common fact for both methods is that such arm's length mark-ups may be estimated not only by identifying the mark-up that the same supplier earns in comparable uncontrolled transactions (an "internal comparable"), but also by identifying the mark-up that would have been earned in comparable transactions by an independent enterprise ("external comparable").

The arm's length gross profit mark-ups and net profit mark-ups can be determined in two ways:

transactional comparison: the gross profit margin that the tested party earns in a comparable uncontrolled transaction, which initially has not been accepted as an internal comparable

functional comparison: the gross profit mark-ups earned by independent companies performing activities and incurring risks comparable to the those performed and incurred by the tested party. Functional comparison involves a search of comparable companies.

The transactional comparison provides more information about controlled and uncontrolled transactions. At the same time, the functional comparison, which is based on the information available in public databases and in the annual reports of comparable companies to the tested party provides much less concrete information with regard to the activities performed and risks incurred by the companies. Consequently, transactional comparisons are more accurate and thus more likely to attain the broad product and accounting consistency for cost plus method rather than the functional analysis. What is more, the reliability of transactional comparison will be higher than that of functional comparison.

Thus, taking into account that cost plus method attaches a great importance to the accounting consistency and the accuracy in risk measurement, it is evident that the transactional comparison is much more preferable to this method. However, in the case of net margin, there is no priority between the transactional comparison and functional comparison, as the net margin is less affected by transactional differences than price and less affected by functional differences than gross margins. Product and functional comparability is thus less critical in applying the transactional net margin method.

In summary, transfer price is the price charged when one division of a company provides goods or services to another division of the company. There are five transfer pricing methods: comparable uncontrolled price method, resale price method, cost plus method, profit split method and transactional net margin method.

The comparable uncontrolled price method compares the price charged for goods or services transferred in a transaction with an associated enterprise to the price charged for goods or services transferred in an open market transaction under comparable circumstances.

The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. In a resale price method, the

resale price margin (i.e. the gross margin) that the reseller earns from the controlled transaction is compared with the gross margin from comparable uncontrolled transactions.

The cost plus method is similar to the resale price method, but it takes the perspective of a manufacturer selling similar products to associated and independent companies. It adds an appropriate cost plus mark up to the costs of goods sold in order to find an arm's length price.

Where transactions are very interrelated, it might be that they cannot be evaluated on a separate basis. The profit split method first identifies the total profit achieved by the associated enterprises from the controlled transactions in which they are engaged. It then splits those profits between the associated enterprises in a manner, which approximates the division of profits in an arm's length situation as closely as possible.

The TNMM is also one of the transactional profit methods. With this method, the net profit margin (the profit before taxation, interest and extraordinary income and expenditure) relative to an appropriate basis (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction is compared to the net profit margin that a third party operating under similar conditions and performing similar functions would realize from comparable transactions.

Answer to research question 2

The section provides answer to the second research question, which is as follows: "What are the relative strengths and weaknesses of each transfer pricing method?"

It is necessary to know not only the content of each transfer pricing method but also its specifics. In order to make right inferences it is important to possess information about relative strengths and weaknesses of each method because the applicability of the methods vary from case to case. The section is devoted to the specifics of each transfer pricing. The strengths and weaknesses are set out with regard to such factors as reliability and availability of information, comparability of transactions and similarity of functions performed by companies.

The following information about the strengths and weaknesses of each transfer pricing method has been collected with the use of secondary sources.

Comparable uncontrolled price method

Strength:

- The CUP method is the most direct and reliable way to apply the arm's length principle, if it possible to find comparable uncontrolled transactions to apply this method[1].

Weakness:

- It is often difficult to find a transaction between associated and independent enterprises that is similar enough to a controlled transaction, so that no differences have a material effect on price. For instance, a minor difference in the property transferred in the controlled and uncontrolled transactions could materially affect the price even though

[1] See OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 22 July 2010, Para 2.13-2.14

the nature of the business activities performed may be sufficiently similar to gain the same overall profit margin[2].

Resale price method

Strength:

- The resale price method is probably most useful where it is applied to marketing operations. In making comparisons for purposes of the resale price method, fewer adjustments are normally needed to account for product differences than under the CUP method, since minor product differences are less likely to have as material an effect on profit margins as they do on price[3].

Weakness:

- Cannot be applied if the tested party is not engaged in uncontrolled transaction

Cost plus method

Strength:

- The cost plus method is probably the most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy- and-supply arrangements, or where the controlled transaction is the provision of services. As in the resale price method, in determining whether a transaction is a comparable uncontrolled transaction for the purposes of the cost plus method, fewer adjustments may be necessary to account for product differences under the cost plus method than the comparable uncontrolled price method.

Weakness:

- The cost plus method presents some difficulties in proper application, especially in the determination of costs. It is true that an enterprise must cover its costs over a period of time to remain in business but those costs may not be the determinant of the appropriate profit in a specific case for any one year. While in many cases companies are driven by competition to decrease prices by reference to the cost of creating the relevant goods or providing the relevant service, there are other circumstances where there is no noticeable link between the level of costs incurred and a market price. (e.g. where a valuable discovery has been made and the owner has run only small research costs in making it)[4].
- Difficulties with finding comparable data on gross margins because of accounting incompliances that may occur
- Require the information about transactions, which is highly difficult to find

[2] See OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 22 July 2010, Para 2.15-2.16
[3] See OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 22 July 2010, Para 2.21-2.35
[4] See OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 22 July 2010, Para 2.39-2.52

Profit split method

Strength:

- possibility to define a transfer price when there is not enough information about comparable transactions and market prices
- it is suitable for highly integrated operations, for which a one sided method may not be appropriate;

Weakness:

- dependence on access to data from foreign affiliates. As a result, associated enterprises and tax administrations may have difficulty gaining information from foreign affiliates
- Difficulties in obtaining economic and commercial information, which according to the law can be considered confidential for the parties that split the profits.

Transactional net margin method

Strengths:

- One strength of the TNMM is that net profit indicators (e.g. return on assets, operating income to sales, and possibly other measures of net profit) are less affected by transactional differences than is the case with price, as used in the CUP method. Net profit indicators also may be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins.

- Another practical strength of the TNMM is that, as with any one-sided method, it is necessary to examine a financial indicator for only one of the associated enterprises (the "tested" party).

Weakness:

- The net profit indicator of a taxpayer can be influenced by some factors that would either not have an effect, or have a less substantial or direct effect, on price or gross margins between independent parties. These aspects may make accurate and reliable determinations of arm's length net profit indicators difficult. Thus, it is important to pay particular attention at establishing comparability for the TNMM.

In summary, each method has its relative strengths and weaknesses and each has its benefits depending on the case.

Comparable uncontrolled price method is the most direct, simple and reliable way to determine the arm's length price. However, this is possible only when there is reliable data about comparable transaction, which is difficult to find since there can be differences in products and services provided by compared parties. Moreover, even minor differences in compared products and services can affect the applicability of the method.

The resale price method is relatively easier to apply than the comparable uncontrolled price method since fewer adjustments have to be made in order to account for differences than those under comparable uncontrolled price method. Nevertheless, this method can be applied only if the tested party is engaged in uncontrolled transaction.

The main weakness of cost plus method is that it requires a high degree of accounting and product or service consistency, which sometimes cannot be achieved because of the uniqueness of the product or the service. The method has a huge reliance on the transactional comparison, which is difficult to achieve due to the fact that not all enterprises are engaged in uncontrolled transactions and that such kind of information is rarely available.

The main strength of the profit split method is that it uses a two-sided approach, so that it is suitable for highly integrated operations, in which both of the associated parties are engaged. The weaknesses of this method also stems from the fact that employs a two-sided approach: the method cannot be applied if only one of the associated parties contributes to the common activity.

The main strength of transactional net margin method is that it does not require a high level of product comparability and that the functional comparison, which can be conducted through the use of public and company databases can be sufficient factor for application. The main weakness of the method is that it is the last one to use if all the above-mentioned transfer pricing methods are applicable.

Answer to research question 3

The use of global transfer pricing books published by leading auditing companies has enabled to collect valid data on the regulations about transfer pricing set in the Netherlands and thus answer to the research questions 3, which is as follows: “What are the rules and regulations regarding transfer pricing in the Netherlands?”

Firstly, the government body that sets the new rules concerning tax regulations in The Netherlands is called Dutch TAX Authority (DTA). The transfer pricing rules are set out in the Article 8b of the Dutch Corporate Income Tax Act (Wet op de Vennootschapsbelasting 1969). What is more, the regulations in the Netherlands require conformation to an extension to Article 9 of the OECD Model, which comprises the arm’s length principle, a first report purely on transfer pricing matters. The concept of an arm's length transaction is to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other party.

The transfer pricing study should contain sufficient information about how the transfer prices were determined and how they conform to the arm’s length principle. The acceptable pricing methods are comparable uncontrolled price method, resale price method, cost plus method, profit split method and transactional net margin method. There is no priority among the given methods.

The principles set in the OECD guidelines are both accepted and applied in the Netherlands. The OECD guidelines advise the companies to use comparable information, so that the comparables have to be used in order to justify the choice of a particular transfer pricing method. What is more, the reference to comparables in explanatory papers on the transfer pricing legislation underlines the importance of this element in defending transfer prices in the Netherlands. According to transfer pricing legislation, it is not obligatory for companies to employ comparables study in order to justify the choice of the transfer pricing method. At the same time, the absence of comparables study can lead to several issues, since the Dutch Tax Authority will execute the study themselves. Hence, it is recommended that the companies perform the study of comparables themselves to prove that they comply with the arm’s length principle.

The Global Transfer Pricing Country Guide issued by Deloitte highlights another attribute of comparable information, namely its availability. All Dutch companies are obliged to disclose their financial statements in either full or abbreviated form with the local chamber of commerce. Presented information can be used by other companies to support or justify their pricing policy. What is more, financial statements and other disclosed and publicly available information as well as data obtained from corporate income tax returns and state audits can be used by tax authorities to support their position.

The following information concerns the estimation of transfer price with regard to regulations set by Dutch Tax Authority. There are situations in which it is possible to arrive at a single, unambiguous transfer price. Since transfer pricing is not an exact science, however, the method used for determining the transfer price will more often than not produce a range of figures which can be used for determining the price to be employed. The range is defined by the highest and lowest values found. Once the arm's length range is established, the question to be decided is which points within that range are comparable and to which point the price must be adjusted. The OECD Guidelines leave this issue open.

For purposes of determining the range, a distinction should be made between situations in which the reference material consists of variables which are readily comparable and situations where the reference material is less accurate. In the former case, the range will include all variables from the reference material; in the latter case it may be necessary to improve the reliability of the material by means of statistical methods, such as that of determining the so-called "interquartile" range. These statistical methods will narrow the choice and make it possible to identify a relevant range of purer reference material.

Once the range is established, the question to be answered is whether the price of the transaction to be evaluated falls within that range. If that is the case, no adjustment need be made. Only in situations where the price falls outside the range and the taxpayer cannot explain and substantiate this deviation will an adjustment become necessary. The OECD Guidelines provide that the adjustment to be made in such an event is to the point within the range that best reflects all the facts and circumstances of the particular controlled transaction. If it appears that one specific point within the range is commensurate with the terms of the controlled transaction, the adjustment will be to that point. If no such specific point can be designated, the Netherlands will take the position that the price is to be adjusted to the median (mid-point in the range). For purposes of evaluating a transaction, it may be useful to consider figures from two or more years. The use of such multiple year data may obviate the need to make adjustments in a specific year when, as a whole, the group has consistently maintained arm's length prices in past years.

In summary, first, the government body that sets rules regarding tax legislations in the Netherlands is called Dutch Tax Authority. The Dutch Tax Authority requires that the transfer pricing study have to explain how the transfer pricing method was chosen and how the transfer price is determined and how it complies with the arm's length principle. The Dutch Tax Authority accepts the use of five transfer pricing methods: comparable uncontrolled price method, resale price method, cost plus method, profit split method and transactional net margin method. The preference is not given to any of the five methods, but the justification for the chosen method has to be provided. In order to justify the chosen method and the transfer price, companies are advised to use the comparables study, otherwise the Dutch Tax Authority will perform this process itself.

The range of the arm's price is defined by the highest and the lowest values found. When the arm's price length range is estimated, the next step is to decide which points within that range

are comparable and to which point the price must be adjusted. The OECD Guidelines leave this issue open. In case the certain variable within the range is not determined due to the fact that that none specific point within the range is commensurate with the terms of the controlled transaction, the Netherlands will take the position that the price is to be adjusted to the median (mid-point in the range).

Answer to research question 4

An in-depth interview with the Acting Managing Director of LBBV has helped to obtain information about LBBV and its activities, thus providing answer to the research question 4, which is as follows: "What are the main activities of LBBV?"

In the process of interview, the following information was gathered:

The LBBV's core activities are the following:

- physical supplies of bunker fuels and bunkering (back-to-back trade in bunker fuels and gasoils) in the region of Amsterdam-Rotterdam-Antwerp ("ARA"));
- operational/logistics support for LITASCO's trade in oil products on barges in ARA.

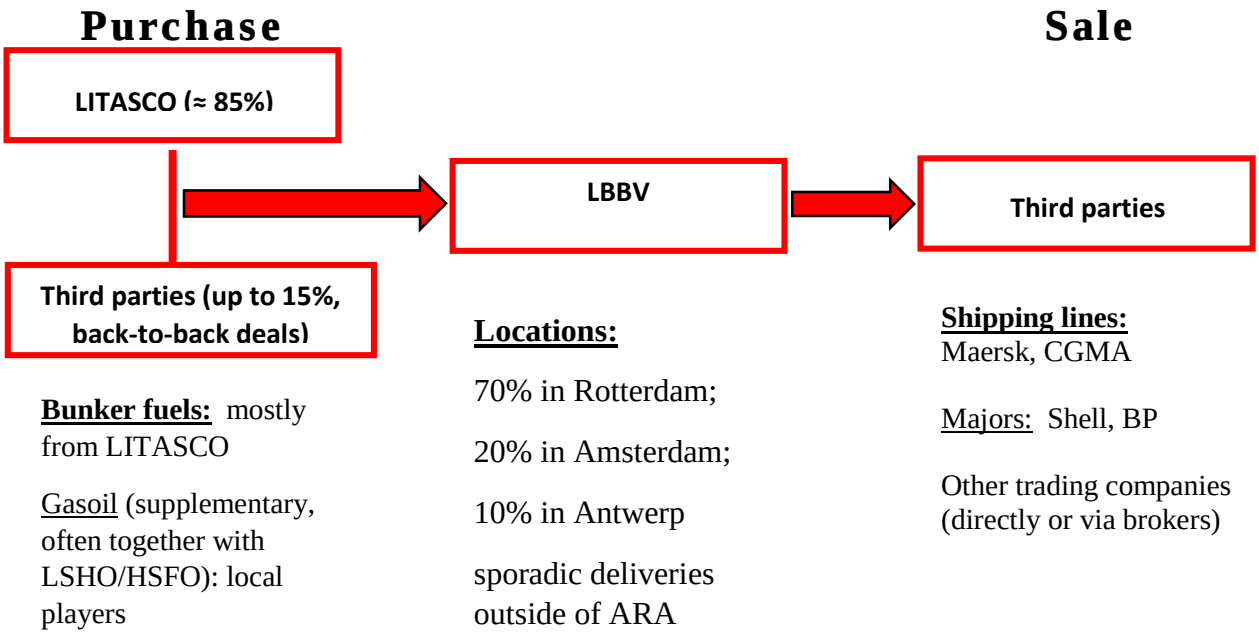


Figure 10LITASCO and LBBV operations 1

Bunker trade (physical supplies and bunkering or back-to-backs)

LBBV purchases almost all amount of bunker fuels from its 100% parent company LITASCO. The rest amount of bunker fuels and gasoil, normally making up to 15% of the total volume, is purchased from third parties for the back-to-back deals. These deals pose no price-related risks. As a bunker trader, the company sells bunker products to a wide range of and trading companies in ARA, including several small Dutch and Belgian ports, and outside of ARA. LBBV is also presented in other European and world's ports as a trader arranging delivery of bunker fuels and bunker gasoil to the shipping lines through the local physical suppliers. The products traded by the Company are intermediate fuel oils with high and low content of sulphur.

The bunker market is prone to some uncertainties and because of these uncertainties LBBV decided to keep a low profile in it and not to expose itself to the risks, which have plagued the market in the last 3 years. As a result, this business is mainly unprofitable. At the same time,

LBBV operates in this market because ARA is a very important region for every oil major. The active presence in ARA is essential to any ambitious company. Besides, LBBV's bunker trade has always been supplementary to another business, trade in oil products on barges.

What is more, LBBV operates in this business in order to assure a security of LITASCO's operations. For example, if LITASCO sometimes purchases more oil products than it can place in the market, then the bunker trade come in to absorb these extra qualities, even though the margin generated is not high compared to the trade in oil products on barges.

Operational/logistics support for LITASCO's trade in oil products on barges in ARA.

The second main activity that LBBV executes is the operational and logistical support for LITASCO's trade of oil products on barges in ARA. That is the business, in which LBBV makes profit.

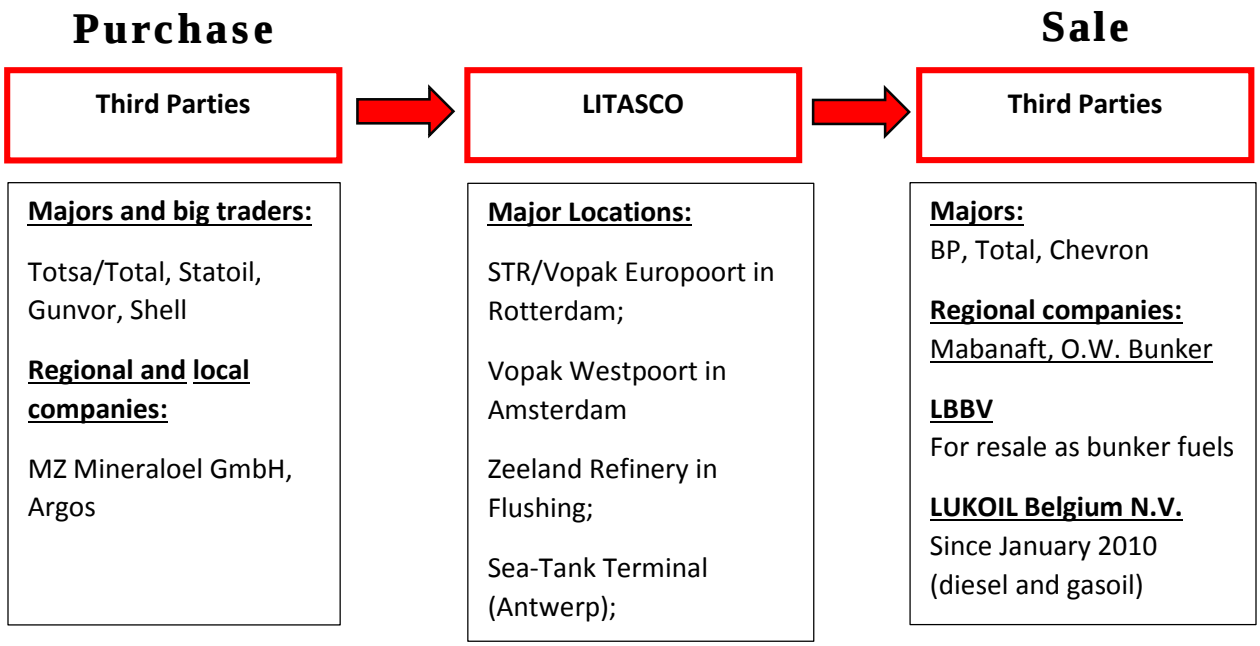


Figure 11 LITASCO SA and LBBV operations 2

The support for LITASCO mainly concerns the covering of LITASCO's activities around Service Terminal Rotterdam and Vopak Europoort in Rotterdam, Zeeland Refinery in Flushing, Vopak Westpoort in Amsterdam and Sea-Tank Terminal/Sea-Tank 510 in Antwerp. Since the second quarter of 2012, LBBV has expanded its operational activities and has been covering LITASCO Group's Spanish operations around the Meroil terminal in Barcelona, in which LITASCO is one of the owning partners. LITASCO trades in a wide range of oil products such as fuel oils, cutterstock, middle distillates (gasoil and gasoline), jet, naphtha, LPG. The products that the company trades in vary from a location to a location.

In summary, LBBV has two activities, which are bunker trading and logistical and administrative support of LITASCO's activities. The first activity is unprofitable, while the second one is the activity, in which the company makes profit.

Answer to research question 5

The following part provides information concerning the formulas and techniques used for determining the arm's lengths price under each transfer pricing method and provides answer to the research question 5, which is as follows: "How to calculate the arm's length price under each transfer pricing method?"

The examples set out below are the same for all transfer pricing methods, thus easing the comparison in the way the methods are calculated.

Comparable uncontrolled price method

A wine producer in country X sells wine to an associated Dutch wholesale company. That same wine producer in country X also sells that same wine to an independent Dutch wholesaler at a price of € 5 per box. The contract with the independent wholesale company provides that the producer will pay the external transport costs. In the relationship between the producer and the associated wholesale company, the external transport costs at € 1.50 per bottle are paid by the wholesale company, not by the producer. The other circumstances are identical for the associated and the independent companies. The resale price per bottle is € 12.50. Because of the difference in contractual terms, the uncontrolled price must be adjusted according to Sections 2.8 and 2.9 of the OECD Guidelines. Using the CUP method, the comparable uncontrolled price can be calculated as follows*:*

price paid by independent wholesale company	5
Minus: difference between external transport costs	*1.50*
CUP for associated wholesale company	3.50

Resale price method

The example used for the resale price method is based on the previous example. The point of departure is the gross profit generated by the independent wholesale company, which can be calculated as follows:

resale price	12.50	100%
minus: price paid by independent wholesale company	5	40%
gross profit margin for the independent wholesale company	7.50	60%

The independent wholesale company performs functions comparable to those of the associated wholesale company, the only difference being that the associated wholesale company pays its own external transport costs and the independent company does not. The associated enterprise will have to receive an amount in consideration for the functions performed by it equal to the sum of the compensation received by the independent wholesale company plus an additional amount to cover the external transport costs. The external transport costs equal 12% of the resale price (that is, € 1.50 per each bottle sold at € 12.50). The arm's length gross margin for the associated wholesale company should, hence, be set at 72% (60% + 12%). The transfer price to be charged to the associated wholesale company can then be calculated as follows under the resale price method:

resale price	12.50	100%
minus: required gross profit margin	9	72%
Arm' length transfer price	3.50	28%

It follows from the example that the purchase price minus the external transport costs are identical for both the associated and the independent wholesale company (€ 3.50 + € 1.50 = € 5).

Cost plus method

A Dutch company A engages in the assembly of computers for the European market on behalf of an independent computer business in country X. The assembly work is performed on the basis of standard instructions used by the computer business in country X. The component parts that are used and the computers assembled are – and remain – the property of the computer business in country X. The fee agreed between A and the computer business has been calculated as follows:

cost basis budgeted (direct and indirect costs of assembly)	100
mark-up budgeted to cover operating expenses plus profit mark-up (60%)	*60*
price	160

A computer business in country Y decides to set up a subsidiary B in the Netherlands for the purpose of assembling computers for the European market. The computers to be assembled by A and B are not entirely similar. B's assembly activities are, however, comparable to A's assembly activities as described above. Added to this is the fact that the risks assumed by the two companies are also comparable: the computer business in country Y also is and remains the owner of the component parts used and the computers assembled. A and B hence perform comparable functions. The direct and indirect costs incurred by B in connection with the assembly activities amount to € 110.

The arm's length price can be calculated as follows under the cost plus method:

cost basis budgeted (direct and indirect costs of assembly)	110
mark-up budgeted to cover operating expenses plus profit mark-up (60%)	*66*
arm's length transfer price	176

Transactional Net Margin Method

TNMM Versus Cost Plus Method

The example below is identical to that used to illustrate the cost plus method, albeit that new information is added about the composition of total costs.

A Dutch company A engages in the assembly of computers for the European market on behalf of an independent computer business in country X. The assembly work is performed on the basis of standard instructions used in the computer business in country X. The component parts that are used and the computers assembled are and remain the property of the computer business in country X. (Transfer pricing methods, 2010)

Additional information: The fee agreed between A and the computer business has been calculated as follows:

Direct and indirect costs of assembly + operating expenses	145	100%
Net profit mark-up	15	10.3%
Arm' length transfer price	160	110.3%

A computer business in country Y decides to set up a subsidiary B in the Netherlands for the purpose of assembling computers for the European market. The computers to be assembled by A and B are not entirely similar. B's assembly activities are, however, comparable to A's assembly activities as described above. Added to this is the fact that the risks assumed by the two companies are also comparable: the computer business in country Y also is and remains the owner of the component parts used and the computers assembled. A and B hence perform comparable functions. Total costs for B are estimated at € 160.

The arm's length price can be calculated as follows under the TNMM:

Direct and indirect costs of assembly + operating expenses	160	100%
Net profit mark-up	16	10.3%
Arm' length transfer price	176	110.3%

Summary

All in all, the findings presented on the basis of information derived in the process of research provide a solid foundation that can be used for making certain inferences. The revealed findings firstly focused on the definition of transfer pricing and transfer pricing methods. There are five transfer pricing methods which comparable uncontrolled price method, resale price method, cost plus method, profit split method and transactional net margin method. What is more, the relevant relative strengths and weaknesses of each method have been pointed out. More to that, the regulations on transfer pricing regulations such as priority in choosing the method and adjustment of prices have been set out. Finally, the description of LBBV and its activities were outlined through the interview carried out with the Acting Managing Director of LBBV. The collected information concerned the two main activities performed by LBBV, one of which is the logistical support of LITASCO's operations.

Introduction to the next chapter

The next chapter outlines an inference made on the basis of the research findings. The conclusions made from the research findings focus on the optimal transfer pricing method that has to be chosen with regard to the rules and regulations set by Dutch Tax Authority. Further, the chapter provides the recommendations worked out with the help of conclusions. The recommendations concern the arm's length transfer price that should be set within the chosen transfer pricing method.

Chapter 5. Conclusions and recommendations

Introduction

The chapter provides the assumptions and inferences made on the basis of the data obtained in the process of the research. It aims at analyzing the answers to the research questions outlined in the "research findings" chapter, providing the conclusion based on the data obtained on all research questions together and working out recommendations about the transfer price that should be set for the chosen transfer pricing method. Furthermore, the chapter focuses on the described transfer pricing methods, their strengths and weaknesses and analyzes them together with regard to the activities of LBBV. As a result, the method that is more applicable to the case of LBBV will be chosen.

Conclusion

To start with, it is important to consider the case to which the transfer pricing is applied. According to the Acting Managing Director of LBBV, the company has two main activities which are bunkering and logistical support of LITASCO. In spite of the fact, that the first activity is unprofitable, LBBV operates in this area as ARA region is of high importance to the company. What is more, LBBV wants to maintain its brand image and recognition in this area.

However, taking into consideration that bunkering business is unprofitable, it can be inferred that transfer pricing cannot be applied to this activity. What is more, this activity does not anyhow relate to LITASCO, so that LITASCO cannot price bunkering business activity of LBBV.

Hence, the only activity to which the transfer pricing can be applied is the logistical support provided by LBBV to LITASCO. This service is unique, since LBBV provides it to LITASCO and does not provide it to any independent parties, so that it can be inferred that LBBV is not engaged in uncontrolled transactions.

The following part will analyze the possibility of applicability of each transfer pricing method to the logistical service provided by LBBV to LITASCO.

Comparable uncontrolled price method.

As it was stated in previous chapters, the comparable uncontrolled price method is the most direct and reliable pricing method. At the same time, it requires a high level of transaction comparability, namely it has to be ensured that the tested party, which is LBBV in our case, has to provide the same services to independent parties. However, this is not the case, since it was revealed that LBBV provides logistical support only to LITASCO and thus is not involved in any unc0ntrolled transaction. Hence, the comparable uncontrolled price method cannot be applied.

Resale price method

The resale price method puts fewer restrictions on the comparability of transactions than does the comparable uncontrolled price method. However, in spite of the fact that in making comparisons for purposes of the resale price method, fewer adjustments are normally needed to account for product differences than under the CUP method, the method can be applied only when the tested party is engaged in uncontrolled transactions. Similarly, the comparable uncontrolled price method, the application of the resale price method is not feasible, since LBBV provides the service only to LITASCO, which is a controlled transaction.

Profit split method

The profit split method differs from all other for methods in that it employs a two-sided approach. It means that it identifies and estimates the relative contribution of each affiliated party into common activity separately. It is applied when the one-sided approach is not applicable that is not the case since, logistical support is not the common activity of LBBV and LITASCO. LBBV is the only party that is responsible for this service and LITASCO has no any contribution into this activity. Hence, the profit split method cannot be applied.

Transactional net margin method and cost plus method

In the process of elimination two transfer pricing methods are left, which are cost plus method and transactional net margin method. These methods have a considerable advantage over other in this case, since they allow for identification of the mark-up with the reference to transactions earned in comparable transactions not only by associated enterprises but also independent enterprises (external comparable).

However, the cost plus method attaches a great importance to the use of transactional comparison over functional, implying that the comparable transactions made by independent enterprises have to be found. At the same time, the transactional net margin method does not prioritize among functional and transactional comparison, since the net profit margin requires much less product comparability.

Taking into account that LBBV provides the logistical support, the only service that is subject to pricing, only to LITASCO, the transactional comparison cannot be provided since, it is not possible to find transactions comparable to those between LBBV and LITASCO. The information about comparable transactions is unavailable due to the confidentiality of contracts. The information about independent enterprises performing services comparable to those provided by LBBV is available and was provided by LBBV.

In conclusion, the specifics of each transfer pricing method along with the environment and activities in which LBBV is engaged have enabled to identify the most optimal transfer pricing method. The fact that LBBV is not involved in uncontrolled transactions because it provides logistical support only to LITASCO has considerably facilitated the process of determination of the most optimal method.

Fishbone (most important objective)

In order to reach the main research objective five research objectives were identified, which are as follows:

- identify what transfer pricing is and what transfer pricing methods exist
- observe relative strengths and weaknesses of each transfer pricing method
- find out the rules and regulations imposed by the Netherlands, regarding the applicability of transfer pricing
- determine the main activities of LBBV
- apply each transfer pricing method to the general case

Each of the above-stated research objectives were important in achieving the final result. However, one of the research objectives, which is “Identify the main activities of LBBV” was more important than others.

The most important objective of the research was "to identify the nature of services between LBBV and LITASCO". During the research the main activities of LBBV have been identified in order to understand the specifics of the case to which the transfer pricing is applied. The information obtained during the research process has considerably facilitated the choice of the most optimal transfer pricing method, since it was revealed that LBBV provides logistical support to LITASCO and that this service is provided only to LITASCO. Hence, it has been inferred that LBBV is not engaged in uncontrolled transactions, so that the methods that require that the tested party have to be involved in uncontrolled transactions were eliminated.

Recommendations.

The following part concentrates on the recommendations that can be given to LBBV on the basis of the chosen transfer pricing method. The transfer price that should be set between LBBV and LITASCO has been estimated with regard to the rules and regulations set by Dutch Tax Authority.

The arm's length price under the transactional net margin method is estimated on the basis of net margins of comparable companies, namely the companies that perform functions and bear risks similar to those done by the tested party. As a result of comparables analysis provided by the company through its database, 10 companies providing services comparable to those provided by LBBV to LITASCO have been found. The following table shows the companies and gives information about their net profit margins.

#	Company Name	Net profit Mark-up	Net profit Mark-up	Net profit Mark-up	Net profit Mark-up	Net profit Mark-up	AVG Net profit Mark-up
		2009	**2010**	**2011**	**2012**	**2013**	**2009-2013**
1	CGR Legal	2.1%	6.3%	12.8%	7.7%	2.1%	6.2%
2	De Andres Y Artinano SLP	0.4%	7.2%	4.4%	4.5%	5.5%	4.4%
3	Ferco	14.3%	6.5%	6.2%	5.5%	6.0%	7.7%
4	Gestoria Pradilla SL	6.5%	2.5%	3.7%	3.0%	3.9%	3.9%
5	Improven Consulting SL	36.3%	19.2%	23.3%	9.3%	8.9%	17.1%
6	J. Causse ET Associes	14.1%	13.0%	13.9%	14.2%	13.8%	13.8%
7	Marimon Abogados SLP	6.9%	5.0%	0.0%	0.2%	0.4%	2.5%
8	Revisjonsfirmaet Asvang & Co AS	22.9%	27.6%	25.2%	23.9%	27.1%	25.3%
9	Saumoy Ribo I Baiges Assessors SAP	10.3%	8.3%	4.0%	4.5%	4.9%	6.4%
10	Sofradec	n/a	23.6%	21.5%	18.7%	10.0%	18.6%

Figure 12 Comparable companies

The use of multiple year data will help to estimate the arm's lengths price more accurately, so that the data about net margins of comparable companies during the last five years has been collected through the use of LBBV's connections with database providers. Further, the average net margin during the last five years for each company has to be calculated.

The following average net margins for each company have been estimated:

AVG (CGR LEGAL) =$\frac{2.1+6.3+12.8+7.7+2.1}{5}\% = 6.2\%$

AVG (De Andres Y Artinano SLP) = $\frac{0.4+7.2+4.4+4.5+5.5}{5}\% = 4.4\%$

AVG (Ferco) = $\frac{14.3+6.5+6.2+5.5+6.0}{5}\% = 7.7\%$

AVG (Gestoria Pradilla SL) = $\frac{6.5+2.5+3.7+3.0+3.9}{5}\% = 3.9\%$

AVG (Improven Consulting SL) = $\frac{36.3+19.2+23.3+9.3+8.9}{5}\% = 19.4\%$

AVG (J. Causse ET Associes) = $\frac{14.1+13.0+13.9+14.2+13.8}{5}\% = 13.8\%$

AVG (Marimon Abogados SLP) = $\frac{6.9+5.0+0.0+0.2+0.4}{5}\% = 2.5\%$

AVG (Revisjonsfirmaet Asvang & Co AS) = $\frac{22.9+27.6+25.2+23.9+27.1}{5}\% = 25.3\%$

AVG (Saumoy Ribo I Baiges Assessors SAP) = $\frac{10.3+8.3+4.0+4.5+4.9}{5}\% = 6.4\%$

AVG (Sofradec) = $\frac{23.6+21.5+18.7+10.6}{4}\% = 18.6\%$

The transfer price between LBBV and LITASCO has to be found with the use of above-calculated average net profit margins of comparable companies. No transaction made by ten above-mentioned companies is to some extent more similar to controlled transaction than those made by nine left companies. Hence, the arm's length transfer price has to estimated on the basis of the median (mid-point in the range) net profit margin.

In order to calculate the median in a number set consisting of even elements the middle pair of number should be found and then the half value that would be between them. In the following case, the middle pair of numbers consists of 6.4 and 7.7.

In the range of net profit margins

{2.5 , 3.9 , 4.4 , 6.2 , 6.4 , 7.7 , 13.8 , 18.6 , 19.4 , 25.3}

the median is calculated as follows:

$$\frac{6.4 + 7.7}{2} = 7.1$$

The formula for calculating the arm's length price under the transactional net margin method is as follows:

Cost basis = direct and indirect costs of assembly + operating expenses

Arm's length price = cost basis + net profit margin

The financial statements of LBBV have been observed and direct and indirect costs+ operating expenses of the services provided by LBBV to LITASCO are estimated to be 150,000€

Hence, the arm's length price under the transactional net margin method is equal 150,000 * 1.071 = 160,650€

Summary

All in all, the most optimal transfer pricing method and the arm's length price under it have been identified and calculated. The comparison and suitability of transfer pricing methods to the particular case, namely the activities provided by LBBV to LITASCO have been examined. As a result, the first two traditional methods cannot be applied since they require that the tested party is involved in uncontrolled transactions, which is not the case, since LBBV provides logistics services only to LITASCO. The profit split method can be applied only when two parties contribute to the certain product or service. However, LBBV is the only responsible party for this service. Two methods were left: cost plus method and transactional net margin method. The cost plus method could not be applied because it requires a transactional comparison, which cannot be achieved because of unavailability of information about transactions made by unaffiliated companies, and a high degree of product comparability. The only method that can be applied to services provided by LBBV is the transactional net margin method, since the functional comparison is available and a high degree of service comparability is not required.

As part of recommendations, the arm's length price under the transactional net margin method is advised to LBBV. The transfer price has been estimated in compliance with the rules and regulations set by Dutch Tax Authority. It reflects the interests of both the company that wants to minimize the taxes and the government that wants to generate the highest possible tax income.

Introduction to the next chapter.

The next chapter deals with the strategic implementation of the recommendations that were worked out in the previous chapter. The steps that have to be taken by LBBV in order to apply the transfer pricing with LITASCO will be described.

Chapter 6. Strategic implementation

Introduction

The chapters briefly describes the actions that have to be taken by LBBV in order to put the transfer pricing into use with regard to rules and regulations set by Dutch Tax Authority. The steps outlined concern the changes of contracts between LBBV and LITASCO and notification of Dutch Tax Authority of implementation of transfer pricing. What is more, the risks that may be run by LBBV when implementing the transfer pricing are set out in the chapter.

Implementation

First of all, it has been identified that the most optimal transfer pricing method for LBBV is transactional net margin method. Under the transactional net margin method the arm's length net margin with regard to rules and regulations set by Dutch Tax Authority has been calculated, making 7.1%.

Two steps have to be taken by LBBV in order to put the transfer pricing into use:

- Amend the service agreement with LITASCO
- Contact the Dutch Tax Authority in order to notify them about the use of transfer pricing

First of all, in order to make the changes and to put them into use, LBBV and LITASCO have to amend the service agreement and fix the arms' length net margin of 7.1% in the contract. This means that apart from covering all the costs incurred when performing the service for LITASCO, LBBV will have a net profit margin of 7.1%

The second step that LBBV has to make in order to put the transfer pricing into use is to contact the Dutch Tax Authority in order to let it know that the company uses transfer pricing. First of all, Dutch Tax Authority will be aware of the use of transfer pricing and will be prepared when conducting the audit or reviewing its results. Secondly, LBBV will have opportunity to obtain information about what documents it needs to justify the chosen method. What is more, LBBV will able to get to know information whether the comparable analysis is done correctly. This will make the company ready for defending the choice of the transfer pricing method.

Risks

The main risks that the company may face when implementing the transfer pricing is that the Dutch Tax Authority may not agree on the lists of comparable companies. This mainly may occur not due to the difference if databases but due to the difference of criteria on the basis of which the comparable companies were selected. However, the Dutch Tax Authority gives the tax paying company the right to justify and defend the choice of the selected companies. No other risks concerning the implementation of the transfer pricing method can be incurred by LBBV.

Summary

All in all, the measures that have to be taken by LBBV in order to assure that the transfer pricing is applied are identified. First, LBBV has to amend the service agreement with LITASCO by fixing the transfer price in this contract. Secondly, LBBV has to notify Dutch Tax Authority about the use of transfer pricing and provide them the results of comparable analysis in order to assure that it was conducted properly.

Chapter 7. Competencies analysis

Introduction

The chapter focuses on the competencies that have been developed during the studying process at Rotterdam Business School. The chapter starts with the self-reflection on the number of professional and generic competencies. The level of each competency along with its applicability to the thesis research has been assessed and outlined. At the end, the lessons learned from assessment and decision on eligibility on the basis of assessment are pointed out.

Reflection on the competencies

Professional competencies

International Business Awareness

Applicability to research project: Medium

Current level: level 3

The ability to do an extensive research and to make a transparent synopsis of an international study.
On this basis he can advise management on the opportunities and threats in the international legal and business environment.
The student shows a clear interest in international developments beyond the immediate scope of his own activities and reads specialist literature on this topic.
The ability to attune his own activities and those of the company to international trends.

Reflection

During my studies at Rotterdam Business School, I did a project on the expansion of Peterson Control Union, the company that issues fishing certificates, into Brazilian market as part of my "Emerging markets" subject. An extensive analysis of the fishing industry along with specifics of doing business in Brazil was conducted. What is more, during my thesis I am researching the specifics of taxing regulations in the Netherlands, so that the "international business awareness" is used during my thesis.

Intercultural competence

Applicability to research project: Medium

Current Level: level 3

The student can recognise and appreciate cultural differences in behaviour and values.
He has developed an open attitude and is motivated to work abroad.
He can make effective use of empathy, or 'frame of reference shifting', to understand and be understood across cultural boundaries.
He can maintain an international network essential to his tasks and to the company.

Reflection

My double-degree program at Rotterdam Business School as well as an internship at QBEX Logistics B.V., a Dutch-based logistics company, can serve as evidence of my international attitude and exposure. What is more, I have been a project leader in culturally and nationally diverse groups in various subjects at Rotterdam Business School. Taking into consideration that

I am doing my thesis in a foreign company, in which I have to conduct my research in an international environment, intercultural competence will be important.

International Strategic Vision Development
Applicability to research project: Medium

Level 3:
The ability to translate trends in the environment to opportunities and threats for the organization. He should be able to assess an international strategic policy for a company, clearly defining the strategic limits.
He can contribute to the adjustment of a vision and strategy.
He can assess the consequences of a vision and strategy for business policies and processes.

Current level: 3

Reflection
During my studies at Rotterdam Business School, I did a project on the expansion of Peterson Control Union, the company that issues fishing certificates, into Brazilian market with a thorough consideration of the specifics of the company and do's and don'ts of the business in Brazil. A SWOT analysis as well as Porter's Five Forces model was employed in order to explain, assess and justify the possibilities of the company to achieve success in the new market.

Business Processes & Change Management
Applicability to research project: Medium

Level 3:
The ability to create and change organizational policy while respecting the interdependence between company strategy, business structure and human resources processes.

Current level: 2

Reflection
During my study at Rotterdam Business School, I have developed skills and understanding of organizational policies in the subject "Consultancy & Change", in which our group had to set up and organization and create its policy. Further, the subject "Strategic and Innovation Management" has taught how to optimize and adjust the organizational policy to the specifics of the industry and environment, in which the company operates.

Points of improvement
I assess the level of this competence as "level 2" because I do not have enough experience of working in organizations and thus do not fully understand all the processes in practice. I suppose that in order to fully understand the business processes, I should gain an experience in start-ups or work on a specific project aimed at change management.

Entrepreneurial Management
Applicability to research project: Low

Level 3:
The ability to contribute, in cooperation with others, to an optimal exploration by the company of the opportunities for both new and existing products/services in the market and the necessary risks involved.

The student contributes to a pro- active opportunity-seeking attitude in the company and encourages the company to make effective use of these opportunities.

Current level: 3

Reflection

During my studies at Rotterdam Business School, I have done the project aimed at exploration of business opportunities that would make the society in Africa self-sufficient as part of the "Consultancy & Change" subject. What is more, the subject "Entrepreneurship" has considerably contributed to my understanding of the business opportunities and product and service exploration techniques.

International Marketing and Sales

Applicability to research project: Low

Level 3:
The ability to create, change and implement a strategic international marketing plan which includes an analysis of the international environment of the company's position.
The plan contains strategies in product development, pricing, distribution and international advertising and promotion.

Current level: 3

Reflection

During my studies at Rotterdam Business School, I did a big amount of projects, in which marketing and promotion tools were extensively analysed and described. Subjects such as "Entrepreneurship", "Consultancy & Change" and "Strategic and Innovation Management" attached a great importance to the description and employment of promotional techniques.

International Supply Chain Management

Applicability to research project: Low

Level 3:
The ability to assess international business operations and to advise management on the key issues of supply chain management.

Current level: 3

Reflection

The subject Logistics at Rotterdam Business School as well as the internship at QBEX Logistics B.V., logistics company, has enabled me to develop knowledge in supply chain management.

International Finance and Accounting

Applicability to research project: High

Level 3:
The ability to describe and understand the consequences of the various risks inherent to international business. The ability to contribute to management control of a multinational organization by means of an integrated application of his knowledge of business accounting, management accounting, financial management, and other relevant aspects.

Reflection
During my studies at Rotterdam Business School, I have chosen "Finance and Accounting" as my minor and developed a good understanding of management accounting, corporate finance, relations between financial statements. What is more, the internship at QBEX Logistics B.V. has contributed to my better understanding of cost optimization techniques. My thesis topic requires a high competency in finance, since it deals with tax optimizations techniques and financial statement analysis.

International Human Resource Management

Applicability to research project: Low

Level 3:
The ability to describe, understand and evaluate the general HRM functions and responsibilities
The ability to relate HR policies & practices to overall organisational or corporate objectives in accordance with international labor law
the ability to assume strategic responsibility in formulating relevant HR policies & practices for the further development of the organisation or corporation in international and intercultural context

Current level: 2
Reflection
During the course "Applied Human Resource Management" at RBS, I have gained insight into HR policies and practises and have understood how to develop HR strategies according to the specifics of the industry.

Points of improvement
I assess my level of this competency as "level 2" because I do not a relevant experience in implementation of the HR policies. In order to enhance my HR competence, I should gain a relevant experience in this area.

Generic competencies

Leadership

Applicability to research project: Medium

Level 3:
The ability to choose a role as a leader depending on the situation. He needs to have a great awareness of the different styles of leadership, conflict models and negotiating techniques. He is able to convince others easily by using arguments. He is able to make decisions even when the outcome is unsure and he is able to motivate persons to work in a team.

Current level: 3
Reflection
During my studies at Rotterdam Business School, I have been a group-leader in many projects. I lead a team that consist of various nationalities and age-groups. What is more, apart from being a group leader, I presented the overall results of the projects. Moreover, I have participated in conferences and was a group leader as well.

During my thesis, I have to communicate with highly intellectual, competent and busy people, so that most of the decisions on the thesis research have to made by me. What is more, I need leadership skills when I justify and defend decision that I made to my company supervisors.

Co-operation

Applicability to research project: Medium

Level 3:
The ability to encourage others to obtain results through co- operation by sharing ideas and giving in to the wishes of others, when necessary to progress as a group. The ability to fulfil an exemplary role within the team. The ability to keep contributing and participating, even when he is no longer directly involved. The ability to provide new ideas to improve results collectively.

Reflection
During my studies at Rotterdam Business School, I have been a group-leader in many projects. In spite of the fact that sometimes the results were not achieved immediately, I inspired and encouraged the team to fulfil the potential and accomplish the desired result.
During my thesis, I share my findings and my research plans with my colleagues in order to make them be aware of my research stage, so that "co-operation" competency is important.

Business communication

Applicability to research project: High

Level 3:
Business Communication: Good operational command of the English language in a wide range of real world situations, e.g. can participate effectively in discussions and meetings(level C1)

Current level: level 3
Reflection
During my studies at Rotterdam Business School, I have had a subject Business communication, which considerably enhanced and improved my eloquence and level of understanding of the language. What is more, during my thesis I had to work with difficult taxing documents and a high level of proficiency has helped me to understand the documents. Moreover, the thesis company operates in Oil and gas industry, so that I had to learn new terminology and my command of English has enabled me to adapt easily.

Business research methods

Applicability to research project: Medium

Level 3:
To spot complex issues and to search information from a broad range of resources. To be able to integrate theory and practice. To be able to indicate the information needs in complex situations. To draw conclusions from complex research data.

Current level: 3
Reflection
During my studies at Rotterdam Business School, I have had multiple subjects such as "Applied research methods", "Applied research methods 2" , which have enabled me to develop skills in research. I have learned how to sort out and make inferences from the information, which

sources to use in various cases. I have been taught how to find a necessary information from a wide range of data.
During my thesis, I have collected a lot of information on my topic and research skills were important for me when sorting out the obtained data and ordering them in a logical way.

Planning and organizing

Applicability to research project: Medium

Level 3:
The ability to stimulate others to harmonize the planning and organization of projects and activities in an effective manner, in relation to his own activities.

Current level: 3
Reflection
During my studies at Rotterdam Business School, I have participate in many projects, in which I have developed time-management skills. Planning and organization are highly important for a successful and strong project. By being a project-leader, I organized the meetings and distributed responsibilities.

Learning and self-development

Applicability to research project: High

Level 3:
The ability to know the limits of his competencies, to critically evaluate and account for his own actions, to take criticism and put it to good use. The ability to take feedback, take initiative and work independently.

Reflection
During my studies at Rotterdam Business School, I have learned that there is always a room for improvement. I have understood how important it is to take responsibility and work independently. I have led a lot of group projects and learned to take criticism, understand mistakes and work out the methods to eliminate them. What is more, the participation in various lectures has improved my level of understanding of my skills and the ways, in which I can improve them in future.
My thesis requires a high level of "learning and self-development" competency, since it deals with a very specific topic, in which I do not possess sufficient initial knowledge. However, during the process of research, I have substantially improved my understanding of the topic, so that I possess a solid theoretical background to achieve the main thesis objective.

Ethical responsibility Corporate Responsibility

Applicability to research project: low

Level 3: The graduate should be able to contribute actively to a corporate social responsibility policy, like an ethics work group or committee. He is able to handle dilemmas in a manner that he shows that he is responsible for and can be held accountable for.

Current level: 3

Reflection

During my studies at Rotterdam Business School, I took a subject “Corporate Social Responsibility” which considerably improved my understanding of CSR policies and concepts and rules and regulation regarding CSR. What is more, I undertook a project which aimed at improvement and implementation of CSR policies in a particular company, so that I have learned how the theory and concept of CSR can be applied. What is more, during the project works, I was responsible for distribution of tasks, so that everybody is motivated and satisfied with his contribution into the final result and that no conflicts may occur.

Lessons learned throughout the process

During the process of assessment, I have realised what competencies I should have developed and have developed by studying at Rotterdam Business School. What is more, I have understood the importance of extracurricular activities such as presentations, lectures and internships that enable us to apply and hone the skills that have been gained at Rotterdam Business School. After the process of reflection, I have recognised what competencies have to be improved and what measures have to be taken in order to enhance these competencies. What is more, I have got to know what competencies were highly applicable during my thesis. Firstly, it seemed that only competencies related to finance were of high applicability. Further, during the process of reflection, it was realised that co-operation, leadership, learning and self-development, and other generic skills were also highly applicable to the thesis process.

BBA Eligibility

After reviewing the competencies and assessing them, I am convince that I am eligible for BBA degree. I have developed almost all the competencies to the highest level. What is more, I have also applied some of the competencies during the extracurricular activities by taking part in presentations, guest lectures, visiting career events and more importantly, by taking internships where I could use my competencies in combination. Moreover, during my thesis, I have applied some of the professional competencies such as international finance and accounting, international business awareness and intercultural competence and all the generic competencies. All in all, I am convinced that not only by acquiring theoretical knowledge but also applying them in different situations, I have developed competencies of student eligible for BBA degree.

Summary

In summary, the self-reflection on competencies has helped realize a real level of my development at the end of bachelor program. The assessment has enabled me to understand my strong points and weak sides that have to be improved. What is more, I have realized which of the competencies were used in the process of the research aimed at my thesis.

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Appendix

Interview transcript

Interviewer: Fuad Guseynov

Interviewee: Oleksandr Butsan, the Acting Managing Director of LBBV

Good afternoon, Oleksandr.

Good afternoon.

Could you introduce yourself?

My name is Oleksandr Butsan, I am the Acting Managing Director of LBBV. I have been in this position for 7 years.

Can you briefly describe when/how the LBBV was established?

The parent company of LBBV, the Swiss entity LITASCO SA was set up in 2000 as a trading arm of the entire LUKOIL Group. Later LITASCO SA started to open its subsidiaries/affiliates in the key locations of the world such as Rotterdam, Singapore and New York. LBBV was set up in December 2001 to manage the Group's trading activities in the region Amsterdam-Rotterdam-Antwerp ("ARA").

What are the main activities of LBBV?

There are 2 main activities of LBBV

Main activities

The first main activity is trade in bunker fuels and other bunker products ("the bunker trade").

LBBV purchases bunker fuels almost entirely from LITASCO, our parent company, which is located in Geneva, Switzerland. LBBV occasionally purchases bunker fuels and gasoil from the third parties for back-to-back deals, the deals that pose no price-related risk (up to 15%). As a physical supplier, LBBV supplies bunker fuels and bunker gasoil to large and medium shipping lines (owners/charterers). As a bunker trader, LBBV sells bunker products to different physical suppliers and trading companies in the region Amsterdam-Rotterdam-Antwerp ("ARA"), including some smaller Dutch and Belgian ports. The company has presence in the other European and world's ports as a trader arranging delivery of bunker fuels and bunker gasoil to the shipping lines through the local physical suppliers.

The second

The second main activity provided by LBBV is the operational and logistical support for LITASCO's trade of oil products on barges in ARA.

The support for LITASCO mainly concerns the covering of LITASCO's activities around Service Terminal Rotterdam and Vopak Europoort in Rotterdam, Zeeland Refinery in Flushing, Vopak Westpoort in Amsterdam and Sea-Tank Terminal/Sea-Tank 510 in Antwerp. Since the second quarter of 2012, LBBV has expanded its operational activities and has been covering LITASCO Group's Spanish operations around the Meroil terminal in Barcelona, in which LITASCO is one of the owning partners. LITASCO trades in a wide range of oil products such as fuel oils,

cutterstock, middle distillates (gasoil and gasoline), jet, naphtha, LPG. The products that the company trades in vary from a location to a location.

I have checked the market share of LBBV in and noticed that it has been fluctuating in the past 5-6 years and that LBBV is losing its market position. What factors could trigger such changes?

First of all, as you could see that the bunkered volumes in 2010 were 11.9 million tonnes, while those in 2012 were 10.9 million. At the same time, the market share in 2010 was 10.9% while that in 2012 was 5.2%. These figures indicate that the market is saturated, the competition in this industry is fierce and that the market is prone to some uncertainties. Because of these uncer5t6ainties LBBV decided to keep a low profile in the market and not to expose itself to the risks, which have plagued the market in the last 3 years. As a result, this business is mainly unprofitable.

Why do you still operate in this area?

ARA is a very important region for every oil major. The active presence in ARA is essential to any ambitious company. Beside LBBV's bunker trade has always been supplementary to another business, trade in oil products on barges. Before 2009 this activities was on the books of LBBV, since then – on the books of LITASCO SA. But the bunker trade has always been secondary to the trade in oil products on barges, yet it has been playing an important role of the outlet. In other words, it is advisable for the company of the group which trades in oil products on barges to be engaged in the bunker trade and provide a possible outlet.

For example, if LITASCO sometimes purchases more oil products than it can place in the market, then the bunker trade come in to absorb these extra qualities, even though the margin generated in not high compared to the trade in oil products on barges.

Let us move on to the purpose of our interview. What is the aim of transfer pricing for LBBV and LITASCO?

As I have already mentioned, LBBV undertakes a lot of supporting activities on behalf of LITASCO. One of the purposes of every business is maximization of the profit and LITASCO is not an exception. One of the targets of LITASCO is to generate the highest possible revenue with respect to other factors stated in the mission statement. However if LITASCO SA needs to maximize its profit, LBBV provides services for LITASCO SA, reinvoices LITASCO SA and generates a service income, which becomes part of the consolidates financial statements of the LITASCO Group, then LBBV should minimize its taxable income.

Final set of comparable companies

#	Company Name	Main activities	Country
1	CGR Legal	Accounting, bookkeeping, legal activities	FRANCE
2	De Andres Y Artinano SLP	Legal activities, bookkeeping	SPAIN
3	Ferco	Accounting, bookkeeping and auditing activities;	FRANCE
4	Gestoria Pradilla SL	Business and other management consultancy activities	SPAIN
5	Improven Consulting SL	Business and other management consultancy activities	SPAIN
6	J. Causse ET Associes	Accounting, bookkeeping and auditing activities; tax consultancy,	FRANCE
7	Marimon Abogados SLP	Bookkeeping, administrational support	SPAIN
8	Revisjonsfirmaet Asvang & Co AS	Accounting, bookkeeping and auditing activities;	NORWAY
9	Saumoy Ribo I Baiges Assessors SAP	Accounting, bookkeeping and auditing activities;	SPAIN
10	Sofradec	Accounting, bookkeeping and auditing activities;	FRANCE