

# XYZ Company

**Benchmarking Analysis for Fiscal Year 2019**

**Payment of Interest on Inter-company loan**

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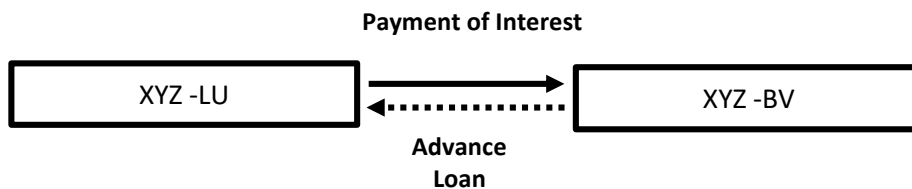
## **1. BACKGROUND AND UNDERSTANDING**

XYZ Company is a company incorporated under the laws of the Luxembourg, has engaged -----("Andersen") to undertake a benchmarking analysis and prepare a benchmarking report to examine the Interest pay-out in relation to the inter-company loan transaction entered between XYZ Co. ("the borrower") and its AE viz. XYZ BV, Netherlands ("XYZ -BV" or the "lender"), for the tax year ending on December 31, 2019 ("FY 2019").

The transaction covered ("**Covered Transaction**") for the purpose of analysis in this report is discussed below:

### ➤ **Interest payment to XYZ-BV**

#### Relevant Transaction Flow for Covered Transaction



The study is based on the Transfer Pricing guidelines issued by the Luxembourg Inland Revenue. The study is also based on the OECD TP Guidelines for Multinational Enterprises and Tax Administrations ("**OECD TP Guidelines**"). Widely accepted by the international community, the OECD Guidelines endorse the arm's length principle as the international standard for the evaluation of transfer prices and promulgate guidelines for its application. The Luxembourg TP Regulations are consistent and harmonious with the OECD TP Guidelines and accordingly, the Luxembourg TP Regulations and OECD Guidelines are hereinafter referred to as the "**TP Regulations**".

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## 2. SCOPE OF THE REPORT

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The firm assisted Andersen with the preparation of this report solely for undertaking **the aforementioned benchmarking analysis i.e. Payment of Interest on inter-company loan to its AE**. Accordingly, this document is limited to a comparable company search and cannot be considered as the TP documentation.

This work shall not be used for any other purpose and may not have considered issues relevant to any third parties. Thereby, any use such third parties intends to make of this report is entirely at their own risk and we shall have no responsibility whatsoever in relation to any such use.

The TP benchmarking analysis of the transaction pertaining to **Payment of Interest on inter-company loan**, in this report is in accordance with the TP regulations and based on the information in the public domain and analysis of information provided by the management of the Company.

This report represents our conclusions only and should not be taken as an assurance of the ultimate treatment of the controlled transactions by the tax authorities of the various countries where the Company and its affiliates operates. The analysis contained in this document is not binding on the tax authority and should not be considered as an assurance that the tax authority will necessarily agree with our conclusions or that, the Company or its affiliates will prevail if the tax authority adopts a contrary position. Any other tax matter, including, but not limited to, other corporate income tax aspects, VAT or customs issues, as well as accounting and legal matters, which may or may not relate to the covered transactions under review, fall outside the scope of this report.

The report also contains information obtained from third-party sources such as information databases, filed annual accounts and relevant industry publications. Although we have used our experience to assess, as far as was reasonably possible, the reliability and suitability of such third-party data, however its accuracy cannot be guaranteed.

The following sections of this benchmarking report provide a description of functional and economic/ benchmarking analysis undertaken to identify independent comparable companies and present the results of the financial analysis performed.

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### **3. CORPORATE & BUSINESS OVERVIEW**

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- **TOMIA GROUP**

TOMIA group was formed from the merger of XYZ Mach group and Telarix group, industry veterans in Roaming, Clearing and Interconnect. Under the new brand and management, the company introduces the industry's first end-to-end platform for maximizing margins from roaming, clearing and interconnect. TOMIA launched with a clear vision to lead innovation that will support digital transformation and connectivity with technologies such as Artificial Intelligence, Machine Learning and Blockchain./

TOMIA offers transformative connectivity solutions to service providers worldwide. Its innovative offering enables customers to manage a unified optimization process of both roaming and interconnect while driving the future of connectivity through new technologies and services such as VoLTE, NFV, IoT and 5G.

- **XYZ MACH GROUP**

The XYZ Mach Group is engaged in the development, marketing and provision of Network Solutions, Clearing Solutions and Fraud & Analytics solutions. The XYZ Mach Group provides complete solutions, which simplify and optimize roaming management for cellular operators.

- **XYZ S.A.R.L**

XYZ S.a.r.l. is a limited liability company , incorporated under Luxembourg law, having its registered office at Luxembourg and registered under number B 180258 (the "Borrower").

- **XYZ BV**

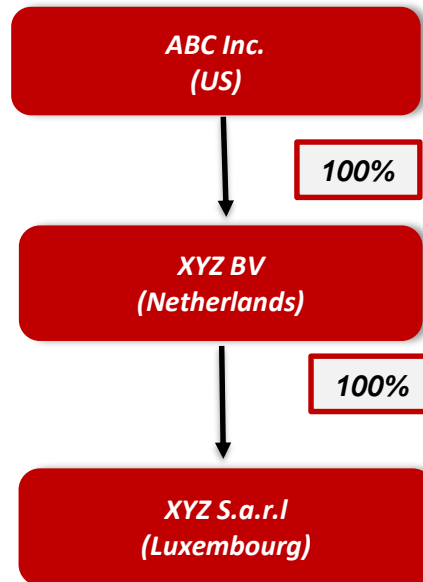
XYZ BV is a private limited liability company, incorporated under Netherlands law, having its corporate seat in Amsterdam, the Netherlands and registered with the Chamber of Commerce of Amsterdam under number 34119625 (the "Lender").

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- **Shareholding Structure**

The following chart depicts the relationship between **XYZ -LU** and **XYZ -BV**:

*Figure 1: Organization structure*



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## 4. FUNCTIONAL ANALYSIS

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### • Background

A functional analysis identifies the functions undertaken by each enterprise, the risks each enterprise assumes and the assets used by each enterprise in the transaction. It also assists in determining the economic value added by each enterprise involved in the international transaction.

The importance of functional analysis emanates from the fact that it defines roles, responsibilities and risks assumed by each transacting enterprise and examines the economic substance of the transactions and the business of the company as a whole. Functional Analysis can be defined generally as the process of identifying the components of a business transaction that contributes to the realization of proceeds from a transaction. It aims at identifying all 'Value-added activities', i.e. all activities that are encompassed in the development, manufacturing, or marketing/customer relation process or in the provision of services. The identification of these relevant activities and processes will aid in understanding the specific risks and economics associated with the transactions. Further, this analysis can aid in identifying specialized and critical business assets and activities that are fundamental to the business.

In order to appreciate the functional analysis of XYZ -LU controlled transaction, it is prudent to have an understanding of its over-all transaction in relation to Payment of Interest on inter-company loan from XYZ -BV. Accordingly, a broad analysis has been undertaken with respect to the inter-company loan transaction between XYZ -LU and XYZ -BV.

### • Description of the covered transaction

XYZ -LU obtained an unsecured inter-company loan amounting from the lender as per the following terms:

- Loan Agreement – The loan agreement is dated October 2013
- Amount of facility covered under the loan Agreement – Euro 10,000,000
- Secured or Unsecured – Unsecured
- Period of repayment – 3 Years from the Loan Agreement date
- Whether any of the Lender / Borrower have a credit rating – NO
- Interest rate: 3.5% per annum <<**Please confirm since the agreement mentions 3.5% plus wholesale rate but excel file states of a 3.5% rate**>>
- Interest Due Date: On the last day of each calendar quarter of each year
- Interest Calculation basis: Interest calculated on the basis of the actual number of days elapsed and a year of 365 days.

**<<Please note that the loan agreement is dated October 2013 and states that the loan shall be repaid in full after end of 3 years. However, the loan appears to be outstanding till Dec 2019 with an o/s balance of approx. 5 Million EURO and interest of 1.6 Million EURO. We do not understand this mismatch. However, for purpose of**

**benchmarking we have considered the interest rate is the primary variable to be benchmarked as per TP provisions. As per the loan agreement there is no interest to be charged on unpaid interest and as such the transaction may be considered prejudicial to lender.?**

- Risk Analysis**

Major risks in respect of financing arrangement between **XYZ -LU** and **XYZ -BV** are set out below:

**a) Credit and collection risk**

XYZ -BV, being the lender of loan, bears the credit and collection risk since the interest receivable is spread over a period of time and the borrower might fail to make payment of interest. However, this risk is mitigated since XYZ -LU and XYZ -BV are a part of same corporate Group.

**b) Interest rate fluctuation risk**

*Interest rate fluctuation risk relates to variability in interest rates that can arise due to changes in the prevailing market conditions and government policies.*

Payment of Interest on loan by XYZ -LU is based on EURIBOR rates. Since EURIBOR rate is the underlying rate used for interest calculation, both XYZ -LU and XYZ -BV bear the risk of interest rate fluctuation.

Tabulated below is a summary of the risk assumed by **XYZ -LU** and **XYZ -BV**, participating in intercompany transaction in relation to **the Payment of Interest on inter-company loan to XYZ -BV**. The marks in the following table denote the risk assumed by each enterprise as follows:

Mark	Explanation
-	No or insignificant risk
v	Limited risk
vV	Significant risk

**Table: Risk analysis**

RISKS ASSUMED	XYZ -LU	XYZ -BV
Credit and collection risk	-	v
Interest rate fluctuation risk	vV	vV

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## 5. ECONOMIC ANALYSIS

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The following section describes the economic analyses performed in order to assess the arm's length nature of the Covered Transaction. In light of the same, this section summarizes the economic analysis undertaken to evaluate whether the Interest pay-out on inter-company taken loan by **XYZ** -LU from **XYZ** -BV is in accordance with the arm's length standard as per the TP Regulations. The economic analysis includes a description of the TP method selected and an explanation of why that method was selected as the most appropriate method along with selection of Profit Level Indicator and Tested party.

### 5.1 SELECTION OF THE MOST APPROPRIATE METHOD

A discussion of methods prescribed in the TP Regulations and its appropriateness, or lack thereof, is necessary to properly identify the Most Appropriate Method (“**MAM**”). The MAM is that method which, under the facts and circumstances of the transaction under review, provides the most reliable measure of an arm's length result.

Further, for analyzing inter-company transactions for determining the arm's length result of the transaction, taxpayer must select the MAM that provides the reliable results. According to Chapter II and Chapter III of the OECD Guidelines, the TP methods available for analyzing the arm's length transfer price include traditional transactions methods, such as the comparable uncontrolled price, resale price and cost plus methods and Profit-based methods, such as the transactional net margin method and profit split method, may also be used if they provide a better result than those methods classified as transactional.

The following section discusses each of the methods and selection of the MAM for the transaction under review between **XYZ** -LU and **XYZ** -BV:

- **Traditional Transaction Methods**

- I. **Comparable Uncontrolled Price Method**

The Comparable Uncontrolled Price Method (“**CUP Method**”) evaluates the arm's-length character of a controlled transaction by comparing the price charged in the controlled transaction to the amount charged in a comparable uncontrolled transaction in comparable circumstances<sup>1</sup>. CUP Method requires a high degree of comparability of products and functions such as quality; contractual terms; geographic market; embedded intangibles; and foreign currency risks etc.

For the purposes of the CUP method, an uncontrolled transaction is considered comparable if one of the following conditions is met:

- None of the differences between the transactions being compared or between the enterprises involved in the transactions could materially affect the price in the open market; or
- Adjustments can be made to eliminate the material effects of such differences.

For the prices analysed in this report, the comparability of uncontrolled transactions is determined by reference to interest rates paid between independent parties with similar terms and conditions. There are two types of CUP

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<sup>1</sup> OECD Guidelines: Para 2.13 to 2.20

methods that may be appropriate:

- Internal CUP method: evaluates comparable uncontrolled transactions between one of the related parties and third parties; and
- External CUP method: evaluates comparable uncontrolled transactions between uncontrolled parties.

Since financial transactions are reasonably homogeneous and reliable market data is readily available in public financial sources, reliable comparable uncontrolled transactions can be identified. Therefore, the external CUP method is regarded as a reasonable and direct method to perform an arm's-length analysis for the transactions under review.

## **II. Resale Price Method**

The Resale Price Method (“**RPM**”) tests the arm's-length character of a transfer price in a controlled transaction by reference to the gross profit margin (i.e. gross profit divided by net sales) realized in a comparable uncontrolled transaction. The RPM begins with the price at which a product is resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin (the “resale price margin”) from which the reseller would seek to cover its operating expenses and make an appropriate profit.

The RPM is generally considered inappropriate due to the lack of financial information to analyze the results at the gross margin level. Even if comparability with external comparables could be ascertained, sufficient financial information on the external comparables is generally not available to ensure that their accounting practices are similar and that the allocation of costs between cost of goods sold and operating expenses is consistent. Therefore, an RPM analysis using internal or external comparables could not be applied for analyzing the Covered Transaction.

## **III. Cost Plus Method**

The Cost Plus Method (“**CPM**”) tests the arm's length character of a transfer price in a controlled transaction by reference to the profit mark-up realized in a comparable uncontrolled transaction. The profit mark-up provides both compensation for the performance of manufacturing, assembly or service functions and a return on capital invested and risks assumed by the manufacturer / service provider.

The results under the CPM are more reliable if gross margins can be accurately determined for the tested party and the comparable transactions. This is possible only if the methods of treatment of cost are uniform.

As the CPM is ordinarily applied in cases involving manufacturing, assembly, or other production of goods that are sold to related parties, therefore, it cannot be considered an adequate method to determine the arm's length price for financing arrangement. Hence, the CPM was not selected.

## • **Profit-Based Methods**

### **I. Profit Split Method**

The Profit Split Method (“**PSM**”) evaluates whether the allocation of the combined profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each controlled taxpayer's contribution to that combined profit or loss. The PSM is designed to be applied where transactions are very

interrelated and cannot be reliably evaluated on a separate basis using one of the transactional methods. PSM is particularly relevant when each party to the transaction has significant intangible assets and/ or the operations of the parties to the transaction are highly integrated and cannot be evaluated on a separate basis.

These conditions are not applicable to the transactions analyzed in this report and thus, PSM is not an appropriate method to be used in case of the subject transaction.

## II. Transactional Net Margin Method

The Transactional Net Margin Method (“**TNMM**”) examines the net profit margin relative to an appropriate base (e.g., costs, sales, and assets) realized on the transaction. For example, return on capital employed, or the ratio of operating income to operating assets, may be examined.

Under the TNMM, the standards of comparability are less stringent relative to the other methods with only broad similarity of functions required. Accordingly, comparables need to be broadly similar and some product diversity and limited functional diversity between the controlled and uncontrolled parties is acceptable under the TNMM.

The TNMM has the following practical advantages:

- In the case of TNMM, the net margins (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;
- The net margins may also be more tolerant to some functional differences between the controlled and uncontrolled transactions than gross profit margins; and
- The differences in functions performed between enterprises are often reflected in variations in operating expenses. Consequently, enterprises may have a wide range of gross profit margins but still earn broadly similar levels of profits.

Since we have selected CUP method for benchmarking the subject transaction, following the OECD guidelines on selection of MAM, TNMM has been rejected for benchmarking the transaction under review.

### 5.1.1. RELEVANT DATA

#### ➤ **Internal Comparable Data**

Basis our discussions with management, we understand that XYZ -LU does not undertake same/similar transactions with third parties under similar terms **<Please confirm>**. Accordingly, internal comparable data could not be obtained.

#### ➤ **External Comparable Data**

In order to determine the normal interest rate charged by uncontrolled enterprises to the borrowers, a preliminary search was conducted for interest rates on loans that were comparable to the terms of the loan issued by XYZ -BV to XYZ -LU.

Based on such analysis, comparable transaction level data, which involved information about uncontrolled transactions, including prices, quantity, and transaction terms is capable of being identified. Thus, external CUP data was considered as a reliable CUP.

### 5.1.2. CONCLUSION

The CUP method refers to comparing the price charged or paid for services provided in a comparable uncontrolled transaction with that charged to an AE. Hence, the similarity of products or services will generally be the most important factor under this method. When assessing the factors in determining comparability between controlled and uncontrolled transactions, the Rules provide that the specific characteristics of the property transferred or services provided would also be a relevant factor.

As discussed above, external CUP method can be applied to the international transaction subject to availability of reliable data. As the public information (from authentic sources) on same/ similar uncontrolled transactions is available, the external CUP method can be applied to determine arm's length transfer prices for the inter-company transactions between XYZ -LU and its AE viz. XYZ -BV. Reference in this respect can also be drawn from Para 2.7 of the OECD Guidelines, which states that, *"Where it is possible to locate comparable uncontrolled transactions, the CUP Method is the most direct and reliable way to apply the arm's length principle. Consequently, in such cases the CUP Method is preferable over all other methods."*

The other transfer pricing methods that can be used for determination of the ALP in respect of an international transaction are based on comparison of margins/ profits earned from an uncontrolled transaction with margins/ profits earned from a controlled transaction. Since the CUP method is based on a direct comparison of price (transaction value) from an uncontrolled transaction with price (transaction value) in a controlled transaction, the use of CUP method (over other methods) would provide a more accurate result of ALP.

Given the above discussion, the external **CUP method** was considered as **MAM** to benchmark the covered transactions.

## 5.2 SELECTION OF TESTED PARTY

In any transaction, there would be a minimum of two enterprises. A question arises as to which of the two should be taken for comparison of prices or profit margins with potential uncontrolled comparables. The enterprise which is taken up for comparison is called the "tested party". It may be either the local or the foreign enterprise i.e. any one enterprise to the transaction. Thus, the concept of tested enterprise is of paramount importance in TP examination as it forms the basis of comparability analysis, which is undertaken for ensuring compliance with the TP Regulations.

In order to make comparability analysis to be meaningful, the economically relevant characteristics of the situation being compared must be sufficiently comparable. The tested party should normally be the enterprise in respect of which reliable and accurate data for comparison is easily and readily available with minimal and most accurate adjustments in data used. The tested party is generally the least complex controlled enterprise of the two parties to the transaction.

For the class of international transaction under consideration, XYZ -LU being the borrower has been considered as the "tested party" considering the nature and other characteristic of the loan and availability of comparable data.

### 5.3 SEARCH FOR COMPARABLE UNCONTROLLED DATA

The objective of our search was to determine whether the interest payable on inter-company loan by XYZ –LU to the XYZ -BV/lender is at arm’s length from a transfer pricing perspective. This report provides a description of the approach undertaken to identify comparable loan agreements and presents the results of lending terms between the borrower and lender. The search was conducted to identify interest rates involving similar loan agreements in European Region.

#### Search Process

To identify comparable loan agreements involving Euro as a currency, a comprehensive comparable search was performed on a broad set of agreements. The research was performed using databases such as *Refinitiv Loan Connector*<sup>2</sup> which contains over 500 agreements available through the public filings and other database.

The focus of this search was on identifying comparable loan agreements involving *borrowing currency as Euros* and the geographical scope was to include loan arrangements in *European region*. The comparable having incomplete agreements were rejected. The final comparable agreements were selected on the basis of currency in which loans were given. The following section describe the steps taken for search performed in order to identify comparable entities:

#### ➤ **Step 1: Quantitative Screening**

To identify comparable loan agreements, we have conducted a search on Refinitiv Loan Connector and other databases. These database contains over 500 agreements available through public filings and other databases.

The Primary reports contained description of loan agreement, location of the borrower and lender, maturity period, secured/unsecured nature of loan, borrower’s industry, NACE and SIC code and borrowing currency. The search process yielded a list of **85** potentially comparable Primary reports which matched the specifications of the search strategy applied.

The Primary reports do not contain information on interest rates as well as some other information about facility fee etc. Therefore, further screening was performed and **85** loan agreements were finally selected based on above quantitative criteria.

#### ➤ **Step 2: Qualitative Screening**

As mentioned above, the automated research above resulted in a set of 85 potentially comparable agreements. These agreements were reviewed manually in order to find comparable agreements involving the licensing of technology.

The lending terms of each of the 85 selected agreements as provided in the report were manually reviewed at this stage. The agreements for which at least one of the following criteria were met were rejected:

- ❖ The loan transaction which pertained to non-comparable agreement type such as lending based on

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<sup>2</sup> *Refinitiv Loan Connector is Refinitiv LPC's web-based loan information platform. It includes access to DealScan - the world's number one source for comprehensive, reliable historical deal information on the global loan markets. A simple and intuitive web-based service gives you access to Refinitiv LPC's complete terms and conditions database, covering hundreds of thousands of loan and bond transactions from around the world. We have also used some additional proprietary databases from an external service provider to broaden the results of the search process.*

securities were rejected;

- ❖ The loan transaction with insufficient data to make a decision; and
- ❖ Agreements having variable interest rates were rejected

Rejection Criteria	No. of agreements rejected
Agreements having variable interest rate, insufficient information, etc.	80
<b>Total</b>	<b>80</b>

Finally, following **five agreements** were identified as potential comparable agreements.

**Table : Final set of comparables**

S. No.	Comparable Agreements Unique Code	Borrower Name	Borrower Location	Base Borrower currency
1	RR20190515L01018	Montanaro European Smaller Companies Trust Plc	UK	EUR
2	RR20190514L01502	Recylex SA	France	EUR
3	RR20190518L01502	AS Tallinna Vesi	Estonia	EUR
4	RR20190515L01515	Irish Continental Group PLC	Ireland	EUR
5	RR20190510L01007	Globalworth Poland	Poland	EUR

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## 6. ARM'S LENGTH RANGE FOR FY 2019

### A. FINAL SET OF COMPARABLES FOR FY 2019

The search steps incorporated above resulted in the identification of 5 loan agreements that can be considered comparable to the financing arrangement under review. Table below shows the calculated arm's length range of interest rates as well as the interquartile range and median of the dataset.

*Table : Arm's Length Range of Interest*

S No.	Unique code	Borrower name	Borrower location	Borrower currency	Financial transaction type	Interest rate
1	RR2019051 5L01018	Montanaro European Smaller Companies Trust Plc	UK	EUR	Credit, Loan	7.00%
2	RR2019051 4L01502	Recylex SA	France	EUR	Loan	6.00%
3	RR2019051 8L01502	AS Tallinna Vesi	Estonia	EUR	Loan	4.19%
4	RR2019051 5L01515	Irish Continental Group PLC	Ireland	EUR	Loan facility	1.62%
5	RR2019051 0L01007	Globalworth Poland	Poland	EUR	Credit, Loan	1.33%
<b>Maximum</b>						<b>7.00%</b>
<b>Upper Quartile</b>						<b>6.00%</b>
<b>Median</b>						<b>4.19%</b>
<b>Lower Quartile</b>						<b>1.62%</b>
<b>Minimum</b>						<b>1.33%</b>
<b>No. of observations</b>						<b>5</b>

In order to determine the arm's length range, the interest rate in each of the 5 comparable agreements was analysed.

Based on **25<sup>th</sup> percentile and 75<sup>th</sup> percentile**, the interquartile range of the interest rates earned under independent comparable financing agreements is **1.62 percent** and **6.00 percent** with a **Median of 4.19 percent**.

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## **B. CONCLUSION FOR FY 2019**

The summary of our benchmarking analysis is reproduced in the below section:

Based on the economic analysis and the available information, external CUP was selected as the MAM in accordance with the TP regulations for benchmarking the intercompany/Covered transaction pertaining to the Payment of Interest on inter-company loan by **XYZ** -LU to **XYZ** -BV.

Then, a benchmarking exercise was conducted to identify the potentially comparable agreements that involves borrowing currency as Euros and geographical location as Europe. Following the implementation of certain search criteria and screening measures (as described in the economic analysis section of this report), a set of five comparable agreements were identified. To determine an arm's length range interest rate in each of the five comparable agreements were analyzed.

Based on **25<sup>th</sup> percentile and 75<sup>th</sup> percentile**, the interquartile range of interest rate applied in comparable financing agreements is **1.62 percent and 6.00 percent** with a **median of 4.19 percent**.

In light of the above analysis, the interest rate of **3.5 percent** payable on inter-company loan by **XYZ** -LU to **XYZ** -BV shall be in compliance with arm's length principle.

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## **7. ANNEXURES**Error! Reference source not found.

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## **A. ACCEPT REJECT MATRIX**

*Refer Annexure A*