

[local company legal name]

[country]

Local Country file FYE 20**[XX]**

[date, year]

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1. Introduction

1.1 Purpose of this report

The purpose of this Local Country file is to provide tax administrations more detailed information on the at arm's length nature of the intercompany transactions in which [local company full legal name] (hereinafter referred to as '[Local Opco]') is involved in. [Local Opco] is the [XYZ] group's contract manufacturer in [country].

This information should be seen as a supplement to [XYZ] group's Master file in which a high level overview is provided to place the [XYZ] group's transfer pricing practices in their global economic, legal, financial and tax context (attached as Appendix A).

[Please find a master file framework report on our website which helps you to prepare such a file: <http://www.transferpricingweb.com>]

In this Local Country file we have followed the at arm's length standard as defined in article [insert number] of the [country] corporate income tax legislation. In this article [article number] it is stated that [insert a brief description of the content of the local transfer pricing legislation].

In addition, we took into consideration the Organization for Economic Cooperation and Development ("OECD") Transfer Pricing Guidelines¹ ("OECD Guidelines"), in particular, Chapter V that was last updated in 2015 as Action 13 of the Action Plan on Base Erosion and Profit Shifting from the OECD². The OECD Guidelines provide that affiliated companies should transact with each other using the arm's length principle and, where required or otherwise appropriate, prepare documentation to support the application of that principle. Chapter V of these Guidelines provides specific guidance on documentation, inter alia, for the preparation of a Local Country file.

Please find enclosed a cross-reference table in Appendix B which connects the information requirements of a generic Local Country file as prescribed in the OECD Guidelines with the content of this specific Local Country file for [Local Opco].

1.2 Scope of this Local Country file

[The purpose of this section is to introduce the intercompany transactions under review. Often this is achieved by way of providing a top down description of the group, its parent company, the company subject to review and the intercompany transactions the latter is involved in. Please find sample wording below]

¹ OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, January 2022.

² 'Guidance on transfer pricing documentation and country-by-country reporting - Action 13: 2015 Deliverable', published by the OECD/G20 on 5th October 2015.

2. Description of [local company legal name]

2.1 Introduction

This section provides a description of [Local Opco]. The information provided includes (but is not limited to): a description of [Local Opco]'s management structure, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.

Further, the business in which [Local Opco] operates is discussed, including an indication whether [Local Opco] has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year. Finally, the key competitors of [Local Opco] in [country] are listed.

2.2 Management structure

[Please insert a description of the organizational structure of [Local Opco] and the reporting lines of the various functions, including the reporting lines of top management. Please find below sample wording]

[Suggested information sources: relevant information often can be gathered through questionnaires or interviews with heads of departments]

[Local Opco] operates as [XYZ] group's manufacturing company for the [insert name] products. [Local Opco] is led by its board of directors consisting of the local managing director and [add other board members]. The local managing director reports to [insert function] who is ultimately responsible for the group's production activities. This direct report of [Local Opco]'s managing director maintains its principal office in [city], [country].

[Local Opco] employs some [number] FTEs. The local managing director of [Local Opco] has a number of direct reports. The direct reports are heading the following departments (including FTEs per department):

| Department | # FTE |
|----------------------------------|-------|
| General management | [XX] |
| Financial control and accounting | [XX] |
| Human resources | [XX] |
| Product management | [XX] |
| Research and development | [XX] |
| Planning | [XX] |
| Procurement | [XX] |
| Logistics / warehousing | [XX] |
| Production | [XX] |

4. Functional analysis

4.1 Introduction

This section details the functional and risk profile of [Local Opco] for the year ended 20[XX] for the transactions it is involved in. These details are described in a so-called functional analysis.

The OECD Guidelines state “Application of the arm’s length principle is generally based on a comparison of the conditions in a controlled transaction with the conditions in transactions between independent enterprises. (...) Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is clearly more attractive”³.

In dealings between two independent enterprises, comparison will usually reflect the functions that each enterprise performs, the assets used and the risks assumed. Therefore, in determining whether controlled and uncontrolled transactions or entities are comparable, comparison of the functions taken on by the parties is necessary. This comparison is based on a functional analysis, which seeks to identify and compare the economically significant activities and responsibilities undertaken or to be undertaken by the independent and associated enterprises. Consistent with the OECD Guidelines, the functional analysis covers only “economically significant” activities.

Thus, the functional analysis provides the factual foundation for establishing transfer pricing methods consistent with the arm’s length principle. A controlled transaction meets the arm’s length principle if the results of the transaction are consistent with the results that would have been realized had the same transaction occurred between uncontrolled entities. A functional analysis is essential to the development of transfer pricing policies for the following reasons:

- The functions undertaken by each related party typically correlate with the risks borne and the assets acquired or developed;
- The functions, assets and risks associated with a related party’s operations usually have a significant effect on its expected profitability;
- The functional analysis provides the information and background necessary to the related parties and identifies uncontrolled transactions potentially comparable to the controlled transactions under review.

In the remainder of this chapter, we will describe our understanding of the functional and risk profile of [Local Opco] and its group companies in the various identified transactions, with a particular focus on the role of [Local Opco] in those transactions. The description of the functional analysis reflects the situation as per [month], 20[XX] and onwards.

³ Paragraph 1.33 and 1.34 of the OECD Guidelines.

[Principal]:

- *is responsible for the sale and distribution of finished products;*
- *is responsible for setting and executing the sales strategy.*

[Local Opco]:

- *is not involved in the field sales and distribution.*

4.2.2 Risks borne

A significant portion of the return earned by any company reflects the fact that the business is bearing risks of various kinds. It is a basic commercial principle that, higher assumption of risk entails higher expectation of reward or remuneration i.e. 'returns should follow risks'. Therefore, an appropriate transfer pricing analysis should adequately take into account the risks that exist in business transactions and how such risks are borne, controlled, mitigated by the entities in the controlled transactions.

Risks refer to those business factors that expose a company to variability in its performance and profitability.

[Please note that the descriptions below might differ from the actual situation which is described in the intercompany agreement between principal and [Local Opco]. The actual conduct of parties then prevails and should be included in the paragraphs below. If there is no intercompany agreement in place, please refer to <http://www.transferpricingweb.com> where intercompany template agreements are offered]

4.2.2.1 Market risk

Market risk refers to the loss associated with operating in an uncertain marketplace. Market risk may arise due to demand factors that adversely affect price or volume, such as increased competition in the marketplace, adverse demand conditions within the market, the inability to develop markets, or failure to position products to service targeted customers. Market risk may also be due to supply-side factors, such as fluctuation in the availabilities and prices of raw materials and other inputs.

Under the current contract manufacturing agreement between principal and [Local Opco], the demand side market risks (that is, fluctuations in prices and volumes of [Local Opco]'s finished products) and supply side market risks (that is, fluctuations in input prices for [Local Opco]'s products) are borne by principal. In the agreement, principal offers fixed prices for the finished products and bears any price deviations between actual and budgeted prices of the raw materials and semi-finished products.

4.2.2.2 Customer credit risk

Credit risk is the risk assumed by a firm that its customers, after receiving the product, are unwilling or unable to pay for it.

[Local Opco] bears minimal credit risk since the vast majority of its sales are made to principal, which has strong creditworthiness and applies a relatively short payment term of 30 days.

possible to use the approach that connects evidence from various methods, as long as the arm's-length standard is respected.

Traditional transactional methods are the most direct tool used to find out whether the conditions of trade and financial relations between related businesses correspond with the market conditions. Therefore, these methods are usually preferred to other methods. Traditional transactional methods are the following:

- Comparable Uncontrolled Price method ("CUP");
- Resale Price Method;
- Cost Plus Method.

The complexity of actual business situations may create practical obstacles to the use of traditional transactional methods. In situations where necessary data are not available, where available data are not of a sufficient quality to rely only on these methods, or where they cannot be relied upon at all, the use of other methods for determining an arm's-length price might be considered. The OECD Guidelines describe the following other methods, also known as transactional profit methods:

- Profit Split Method;
- Transactional Net Margin Method.

Generally, businesses can consider a range of methods to establish an arm's length price. The support for the use of the methods is stated below.

6.2.1 CUP method

The CUP method "compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances." Comparability requires that there be no differences that would materially affect the open market price, or that reasonably accurate adjustments can be made to reflect any differences between the controlled and uncontrolled transactions. The extent and reliability of the necessary quantitative adjustments will affect the relative reliability of the CUP analysis. However, "when 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."

6.2.2 Resale Price Method

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. The resale price is then reduced by the appropriate resale price margin [...]. What is left after subtracting the resale price margin from the resale price can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. customs duties), as an arm's length price for the original transfer of property between the associated enterprises." In essence, the resale price method determines an arm's length price for the sale of tangible property by reference to the gross

7. Financial analysis

[This section is only required if local transfer pricing rules prescribe that an analysis should be made of how the actual financial results compare to the results found in the comparables search. Please see below sample language]

This section of the report analyses the actual results realized by [Local Opco] on its intercompany transactions with principal for financial year 20[XX] and compares these results to the results realised by independent third parties.

[Please note that the actual results may have to be segmented in order to be able to analyse the MOTC realized on the intercompany transactions. In the table below we assumed that almost all of [Local Opco]'s results were based on the intercompany manufacturing activities]

The actual operating margin (MOTC) of [Local Opco] for the financial year 20[XX] is shown in the table below.

| Actual results realized in [currency] | 20[XX] |
|--|--------|
| EBIT | |
| Operating Revenue | |
| Operating margin - MOTC (Operating Profit (calculated as EBIT)/(Operating Revenue - Operating Profit)) | [X.X%] |

From the financial analysis, it may be concluded that the actual operating margin of [Local Opco] for the financial year 20[XX] is [well] in line with the financial results realised by the companies yielded in the final sample of the comparables search undertaken.

Appendix B - Cross-reference table

As mentioned in the report, the OECD Guidelines prescribed information that should be included in the local file. The table below presents an overview of the prescribed information with a cross-reference to the specific paragraph in the report.

| Local file documentation requirements | Reference Chapter/Paragraph |
|---|--------------------------------|
| Local entity | |
| <ul style="list-style-type: none"> A description of the management structure of the local entity, a local organisation chart, and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices. | |
| <ul style="list-style-type: none"> A detailed description of the business and business strategy pursued by the local entity including an indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity. | |
| <ul style="list-style-type: none"> Key competitors. | |
| Controlled transactions | |
| <ul style="list-style-type: none"> A description of the material controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, financial and performance guarantees, licences of intangibles, etc.) and the context in which such transactions take place. | |
| <ul style="list-style-type: none"> The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity (i.e. payments and receipts for products, services, royalties, interest, etc.) broken down by tax jurisdiction of the foreign payor or recipient. | |
| <ul style="list-style-type: none"> An identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them. | |
| <ul style="list-style-type: none"> Copies of all material intercompany agreements concluded by the local entity. | |
| <ul style="list-style-type: none"> A detailed comparability and functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, | |