English software translation

THE EASTERN HIGH COURT JUDGMENT

delivered on June 19, 2024

Case BS-6035/2021-OLR
(Department 6)

The Danish Ministry of Taxation
(Attorney-at-Law Steffen Sværke
and Attorney-at-Law Anja
Sommer)

against

EET Group A/S
(Attorney-at-Law Lasse Esbjerg
Christensen, Attorney-at-Law Jef Nymand
Hounsgaard and Attorney-at-Law Mathias
Kjærsgaard Larsen, the latter as trial
candidate)

The High court judges Peter Thønnings, Anne Bendfeldt Westergaard and Thomas Kloppenburg (interim) participated in the decision.

On January 27, 2021, the case was brought before the district court in Lyngby, which by order of February 11, 2021, has referred the case to the High Court, see section 226(1) of the Administration of Justice Act.

Claims

The plaintiff, the Danish Ministry of Taxation, has claimed that EET Group A/S's taxable income for the income years 2010-2012 should be increased by an additional DKK 17,720,000, DKK 63,279,706 and DKK 18,223,159 compared to the Danish National Tax Tribunal's decision of October 28, 2020, so that the increases total DKK 17,720,000, DKK 65,950,000 and DKK 45,140,000 respectively, alternatively that the assessment of the taxable income for the years in question is remitted to the Danish Tax Agency for further processing.

The defendant, EET Group A/S, has, as its main claim 1 and 2, claimed dismissal of the Danish Ministry of Taxation's main and subsidiary claims and has as its main claim 3, claimed that the Danish Ministry of Taxation must recognize that EET Group's taxable income for the income years 2011 and 2012 is to be reduced by an additional DKK 2,670,294 and DKK 26,916,841 respectively, so that the increases total DKK 0. Subsidiarily, EET Group has claimed that the assessment of EET Group's taxable income for 2010, 2011 and/or 2012 is to be remitted to the Danish Tax Agency for reconsideration.

The issues in the case

The case concerns the assessment of EET Group's taxable income for the income years 2010-2012. With reference to section 2 of the Danish Tax Assessment Act, the Danish Tax Agency increased EET Group's taxable income for the income years in question by a total of DKK 128,810,000 by decision of July 8, 2016. By decision of October 28, 2020, the Danish National Tax Tribunal reduced the increases to a total of DKK 29,587,135.

The parties agree that the case involves controlled transactions covered by section 2 of the Danish Tax Assessment Act and that EET Group, when selling to the intra-group sales companies, has had to act in accordance with what could have been achieved if the transactions had been concluded between independent parties (the arm's length principle).

The question is whether EET Group has observed the arm's length principle, including whether the prepared transfer pricing documentation regarding EET Group's sale to the sales companies is so deficient that the Danish Tax Agency has been entitled to increase EET Group's taxable income for the tax years 2010-2012 on a discretionary basis, and if so, whether there is a basis for setting aside the discretion exercised by the Danish Tax Agency.

Case presentation

The Danish National Tax Tribunal's decision of October 28, 2020, regarding EET Group's taxable income for the income years 2010, 2011 and 2012 states, among other things:

> "**Income year 2010**
> The Danish Tax Agency has increased the company's taxable income by DKK 17,720,000 as a result of the correction of the controlled transactions between the company and affiliated sales companies.
>
> The company's main claim is that the increase should be reduced to 0.
>
> The Danish National Tax Tribunal reduces the Danish Tax Agency's increases to DKK 0.
>
> **Income year 2011**

The Danish Tax Agency has increased the company's taxable income by DKK 65,950,000 as a result of a correction of the controlled transactions between the company and affiliated sales companies.

The company's main claim is that the increase should be reduced to 0.

The Danish National Tax Tribunal changes the increase to a total of DKK 2,670,294.

Income year 2012
The Danish Tax Agency has increased the company's taxable income by DKK 45,140,000 as a result of the correction of the controlled transactions between the company and affiliated sales companies.

The company's main claim is that the increase should be reduced to 0.

The Danish National Tax Tribunal changes the increase to a total of DKK 26,916,841.
...

Factual circumstances
The EET Group was founded by brothers Lasse and Per Frost in Denmark in 1986 under the name "Electronic Equipment Trading" (EET) to distribute memory cards. Since then, EET has grown considerably, and the group had a product portfolio of over 400,000 item numbers during the period of the case.

In June 2012, the EET Group acquired the competing French distribution group Europarts SAS, which was one of the largest spare parts distributors in the EMEA region and Russia. In connection with the acquisition, the EET Group changed its commercial name to EET Europarts.

EET Group A/S is part of the EET Europarts Group, which is one of Europe's largest niche distributors of video surveillance products, spare parts and accessories for computers, printers, tablets, and mobile phones. The group is headquartered in Birkerød and has a logistics center in Ballerup and employed approximately 360 employees at the end of 2012, distributed across 27 local sales offices in 21 countries in Europe, the Middle East and Africa.

The EET Europarts Group's core business is to purchase goods from independent suppliers, who are primarily Asian and American manufacturers of electronic components, such as Sony and HP. The goods are shipped via logistics partners to one of EET Europarts' warehouses, from where the goods are resold and shipped to the Group's customers, who are primarily independent commercial resellers of electronic components. These dealers then sell the goods on to end users. The Group is thus located in the middle of the overall supply chain from the producer to the end user of electronic components.

EET Group A/S is responsible for purchasing two types of products for resale:

1. Generic electronic components such as the branded products [redacted], [redacted] and [redacted] as well as non-branded electronic components (also referred to as OEM, Original Equipment Manufacturer).
2. Semi-manufactured electronic components that are assembled into branded products ([redacted] and [redacted]). These products are referred to as Own Brands (OB for short). The semi-manufactured products are branded by EET Group.

EET Group A/S develops, markets, and sells electronic components and has legal ownership of the warehouse, which EET Group A/S also manages. The subsidiaries are sales companies that primarily purchase goods from EET Group A/S for resale.

EET Group A/S has had the following financial results:

EET Group A/S (in t.kr.)	2012 (18 months)	2010/11 (18 months)	2009/10 (18 months)
Turnover	1,036,000	1,245,000	628,000
Gross profit	80,536	41,448	21,954
Gross margin	7.8 %	3.3 %	3.5 %
Operating profit (EBIT)	11,098	17,137	6,310
Operating margin (EBIT margin)	1.1 %	1.4 %	1.0 %

The performance of the entire EET Group is as follows:

EET Group A/S (in t.kr.)	2012 (12 months)	2010/11 (12 months)	2009/10 (12 months)
Turnover	1,427,204	1,217,510	971,634
Gross profit	279,286	248,878	190,172
Gross margin	19.6 %	20.4 %	19.6 %
Operating profit (EBIT)	76,260	78,558	64,402
Operating margin (EBIT margin)	5.3 %	6.5 %	6.6 %

The Company's TP-documentation

At the Danish Tax Agency's request, the company has submitted Transfer Pricing documentation for the income years 2010-2012. The documentation consists of a Master File and Local Files for the sales subsidiaries.

There are three types of controlled transactions with affiliated companies abroad:

1. Sales for resale
2. Service
3. Loans

The Danish Tax Agency's decision only concerns the controlled transaction "sale for resale", which is why only this controlled transaction is discussed below.

The resale transaction is described as the company purchases the goods from third-party manufacturers and resells these goods to the intra-group sales companies. The intra-group pricing of the transaction is determined so that the intra-group sales companies pay cost price (i.e., the price the company has paid to the third-party manufacturers) plus a so-called "profit landed cost" ("profit LC"). This profit element in the pricing is described as follows in the TP documentation:

> *"The profit LC is a standard calculated mark-up. It ranges between 1-5 percent of the cost prices depending on the goods. The residual LC, i.e., the difference between the cost covering LC and the profit LC, leaves a profit at the level of EET-DK."*

In the TP documentation, the sales companies are generally described as follows:

> *"As illustrated in the matrixes, EET-NO buys products for resale in the local market from EET-DK, carries out local sales efforts, sets prices and carries out meetings and seminars with local customers, is responsible for advertising and marketing.*
> *EET-NO assumes very limited risk besides the credit risk of entering into contracts with local customers. Thus, the local account receivables are owned by EET-NO.*
>
> *Conclusively, EET-NO is essentially a low-risk distributor, performing only sales activities and activities directly linked to sales, and owning no significant assets, in particular no intellectual assets."*

As a background to the applied prices being in accordance with the arm's length principle, the company has described in the TP documentation that the TNMM method is applied using gross margins as comparative figures:

> *"For purposes of applying the TNMM, relevant data from EET-NO's management accounts is aggregated into gross profits for own brands and for generic products, respectively, and comparable external gross margins are used for comparison. Thus, a substantially comparable set of independent pan-European distributors, performing broadly similar functions and incurring broadly similar risks as those of the sales activities performed by EETNO, as supported by the functional analysis, was conducted."*

In connection with the TP documentation, the company has conducted database studies to find comparable independent companies whose earnings can be compared with the Group's sales companies.

For the TP documentation for the 2010 income year, a database study was carried out in 2009 using a number of search criteria and accounting data from the period 2005-2007. There are 16 comparable companies. The intervals for the gross margins of the selected companies are described as follows:

Pan-European	Minimum	Lower quartile	Median	Upper quartile	Maximum
Comparable companies	7.79 %	11.90 %	16.40 %	24.44 %	37.04 %

It is concluded in the TP documentation that the transactions were at arm's length, as the total gross margins of the sales companies (both own branded products and generic products (OEM)) are all within the full range of the database survey. This means that the gross margins of the sales companies must be less than the maximum gross margin in the database survey for the intra-group transactions for them to be at arm's length.

As for the TP documentation for the income year 2011, the accounting figures for the selected companies in the same database study described above have been updated so that accounting figures for the period 2008-2010 are used.
The ranges for the selected companies' gross margins for this period are described as follows:

Pan-European	Minimum	Lower quartile	Median	Upper quartile	Maximum
Comparable companies	9.2 %	17.6 %	20.1 %	22.6 %	34.5 %

Similarly, the TP documentation concludes that the transactions were at arm's length, as the total gross margins of the sales companies (i.e., both own branded products and genetic products (OEM)) are all within the full range in the database study. This means that the gross margins of the sales companies must be less than the maximum gross margin in the database study for the intra-group transactions for them to be at arm's length.

For the TP documentation for the income year 2012, a new database search was performed using the same search criteria as in previous years. There are 7 comparable companies and accounting data for 2010-2012 is used for the comparable companies.
The ranges for the selected companies' gross margins for this period are described as follows:

Pan-European	Minimum	Lower quartile	Median	Upper quartile	Maxi Mom
Comparable companies	2.2 %	8.3 %	11.6 %	15.9 %	28.9 %

Similarly, the TP documentation concludes that the transactions were at arm's length, as the total gross margins of the sales companies (i.e., both own branded products and genetic products (OEM)) are all within the full range in the database study. This means that the gross margins of the sales companies must be less than the maximum gross margin in the database study for the intra-group transactions for them to have been at arm's length.

The sales companies' gross margins appear from the individual TP documentation and are summarized in the following table:

Table 30
Sales companies' gross margins on sales of own brands (OB) and other products (OEM) and total gross margins

Sales	Income year 2010			Income year 2011			Income year 2012		

The Danish Tax Agency's decision

In its decision of July 8, 2016, the Danish Tax Agency increased the company's taxable income by DKK 17,720,000 for the income year 2010, by DKK 65,950,000 for the income year 2011 and by DKK 45,140,000 for the income year 2012 with reference to an adjustment of prices, see section 2 of the Danish Tax Assessment Act.

The Danish Tax Agency has described the tax issues in the case as follows:

> *"The case concerns a change in EET Group A/S' taxable income for the income years 2010-2012 in relation to the determination of arm's length settlement when selling goods and services to foreign subsidiaries.*
>
> *The Danish Tax Agency has reviewed EET Group A/S' controlled transactions with its subsidiaries and does not find that arm's length prices are traded with the subsidiaries in all cases.*
>
> *The foreign subsidiaries operate according to the TP documentation as distributors with limited functions, assets, and risks ("limited-risk distributors") and must be remunerated accordingly.*
>
> *(...)*
>
> *The Danish Tax Agency does not find that the company has documented that EET Group A/S has acted in accordance with the arm's length principle when trading with some of the subsidiaries.*
>
> *The Danish Tax Agency attaches particular importance to the following factors:*
>
> - *Analysis of earnings in section 4.1 shows that the sales companies have had high earnings at the expense of EET Group A/S, which has had a trading loss.*
> - *The subsidiaries' earnings fall outside the interquartile range on both gross and net level, in the benchmark prepared by the company.*
>
> *The Danish Tax Agency has used the TNMM method at net profit level to determine the arm's length earnings in the subsidiaries, as this method is, in the Danish Tax Agency's opinion, the most reliable on the available basis".*

In the accompanying case presentation, the Danish Tax Agency has further justified the increase.

In the case presentation, the Danish Tax Agency has calculated the net earnings (EBIT) for the same companies included in the company's database investigation for the income years 2011 and 2012. These are calculated as follows:

2011:

1st quartile	2.26%
Median	2.77%
2nd quartile	5.05%

2012:

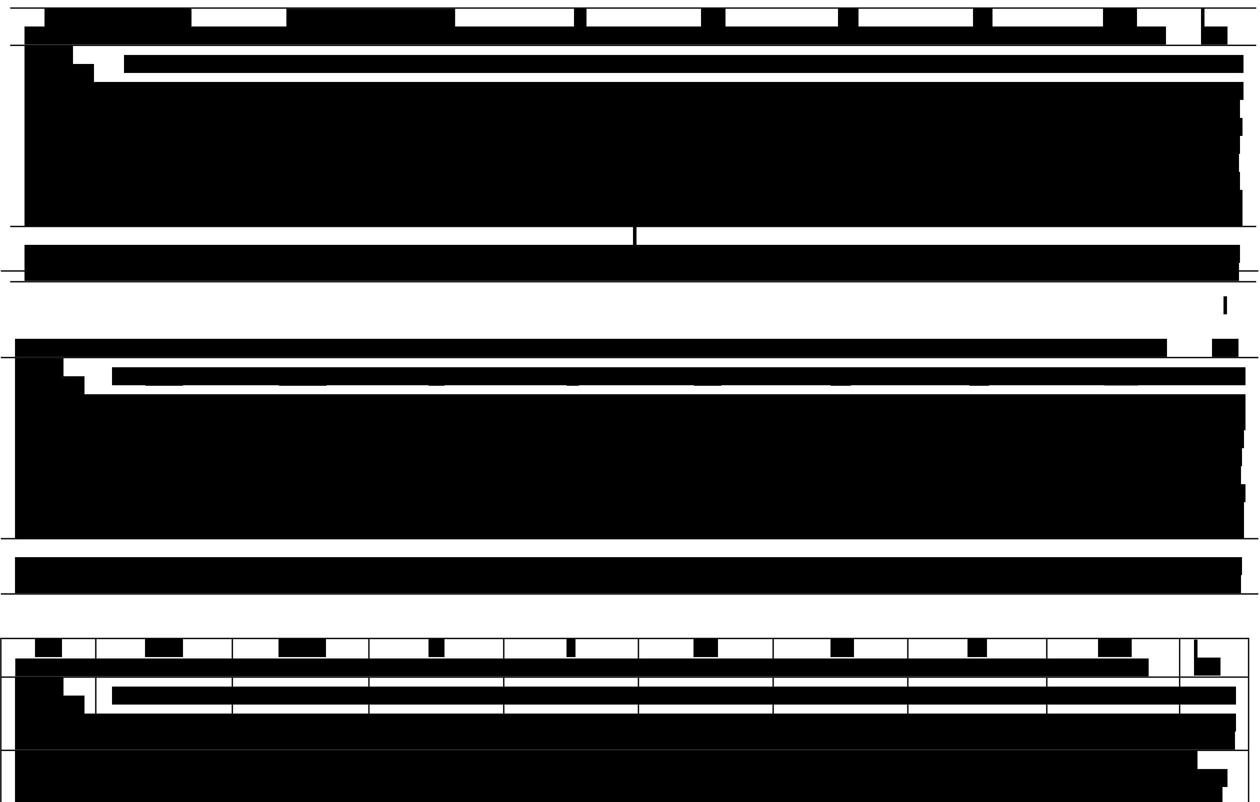
1st quartile	0.92%
Median	2.48%
2nd quartile	4.45%

The Danish Tax Agency has commented on the company's choice of method as follows:

"The Danish Tax Agency does not agree that the company uses the TNMM method. As the company compares at gross profit level, the resale price method is used. The fact that the resale price method, cf. TPG 2.58, must be used consistently with TNMM does not change this. By definition, the TNMM method is applied by comparing at net profit level, whereas the resale price method compares at gross profit level."

The Danish Tax Agency has asked the company for segment accounts so that the operating costs of the sales companies can be allocated to the two product groups, OEM and OB respectively, and that the sales companies' EBIT could be shown as for the two product groups. The company has replied to the Danish Tax Agency that it is not possible to make such a distribution. To show the distribution of earnings, the Danish Tax Agency has then distributed the operating costs in the sales companies in relation to turnover on the two product groups.

Thus, the Danish Tax Agency has summarized this information of the earnings in the sales companies as follows:



The Danish Tax Agency has noted that the net earnings in the foreign sales companies amount to more than 10% on average.

Regarding the earnings in EET Group A/S, the Danish Tax Agency has, by comparing the annual accounts with the consolidated accounts submitted by the company, calculated the earnings on internal and external sales, respectively. According to this calculation made by the Danish Tax Agency, the company's earnings on controlled transactions are negative. The Danish Tax Agency has presented this as follows:

EET Group A/S	**2009/10**			**2010/11**		
DKK million.	Internal	External	Total	Internal	External	Total
Turnover	485.8	142	627.8	962.2	283	1245.2
EBIT	-3.1	9.4	6.3	-6.2	23.3	17.1

On this basis, the Danish Tax Agency has concluded that EET Group A/S has made a loss on trade with the controlled entities, while the foreign sales companies have made a profit on trade. This may indicate that the pricing has not been in accordance with the arm's length principle.

The Danish Tax Agency has stated the following regarding the earnings in the sales companies at gross profit level:

> *"The result of the company's benchmark shows that the median of independent companies' gross margin is 11.59% for the period 2010-2012 with an interquartile range between 8.32% and 15.88%. The overview of the subsidiary companies' earnings in section 3 shows that all companies' gross profit is outside the interquartile range. Thus, the company has not documented that the pricing method used has resulted in trading made in accordance with the arm's length principle.*
>
> *If the subsidiaries' earnings are to be within the interquartile range and correspond to the median of the company's benchmark at gross profit level, the subsidiaries' earnings should have been approximately DKK 40 million lower in 2010, approximately DKK 90 million lower in 2011 and approximately DKK 60 million lower in 2012.*
>
> *If the upper quartile is used instead, the difference is approximately DKK 25 million, DKK 55 million and DKK 30 million for the years 2010-2012"*

The Danish Tax Agency has also stated that the Danish Tax Agency agrees with the company that the subsidiaries must be tested parties in terms of arm's length earnings, but that the Danish Tax Agency does not agree that gross profit on the present basis is the best measure of earnings. As reasons for this, the Danish Tax Agency has stated the following:

"

- *Differences in accounting standards are not taken into account, as this may lead to differences in classification of operating expenses between the company and the independents, weakening comparability.*
- *There is no data available on gross margins with independents, which has led the company to calculate synthetic gross margins.*

- *A comparison of the benchmarks prepared by the company for 2008 - 2010 and 2010 - 2012 shows a significant difference in gross profit levels, as the median fluctuates from approx. 11 - 20 % while the net profits achieved are at the same level. This shows that there is a large difference in the operating cost intensity of the comparables in the two benchmarks. A difference that is not adjusted for."*

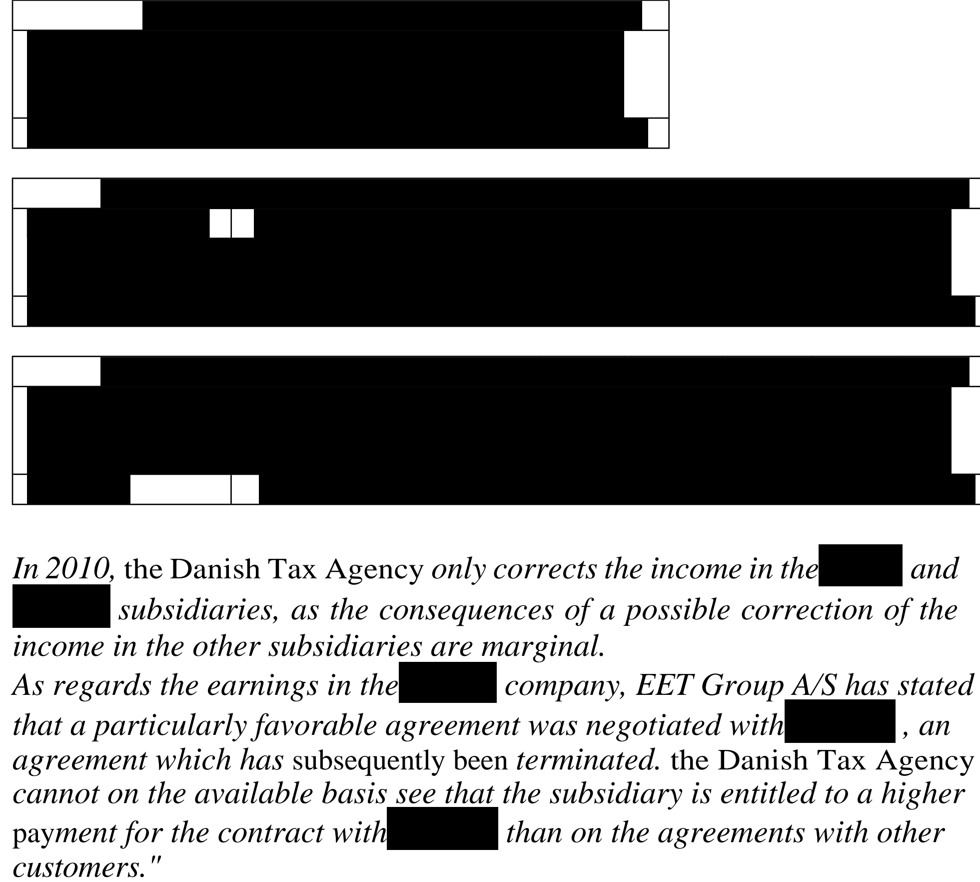
The Danish Tax Agency has thus stated that the most suitable method for determining an arm's length remuneration of the sales companies is the TNMM method, where the EBIT margin of independent companies is compared with the EBIT margin of the sales companies.

The Danish Tax Agency has thus concluded the following:

"A calculation of net profit based on the company's benchmark for 2010 - 2012 shows an interquartile range of 0.92 - 4.45% with a median of 2.48 %, cf. section 2.4. The Danish Tax Agency*'s analysis of earnings in section 4.1 shows that all the selected companies fall outside the interquartile range at net profit level.*

Based on an overall assessment of the case - including the level of earnings in the company's benchmark - as well as the subsidiaries' functions and risks, it is the Danish Tax Agency*'s assessment that the EBIT margin, cf. the arm's length principle in section 2 of the Act, must be adjusted to 2.5% for 2010 - 2012.*

Setting earnings in the subsidiaries to EBIT corresponding to the median 2.5% in the company's benchmark for 2010 - 2012 results in the following corrections to the taxable income (DKK million):



In 2010, the Danish Tax Agency *only corrects the income in the [redacted] and [redacted] subsidiaries, as the consequences of a possible correction of the income in the other subsidiaries are marginal.*
As regards the earnings in the [redacted] company, EET Group A/S has stated that a particularly favorable agreement was negotiated with [redacted], an agreement which has subsequently been *terminated.* the Danish Tax Agency *cannot on the available basis see that the subsidiary is entitled to a higher* pay*ment for the contract with [redacted] than on the agreements with other customers."*

The complainant's opinion
In a complaint dated October 6, 2016, the company claimed that the Danish Tax Agency's increases should be reduced to 0. The company has elaborated on its arguments in support of this claim in a supplementary letter of complaint dated January 17, 2018.

In general, the company claims the following:

> *"EET Europarts generally claims that* the Danish Tax Agency*'s increases of EET Group A/S' taxable income are unjustified because EET Europarts has made a correct pricing according to the arm's length principle.*
>
> *EET Europarts' pricing methodology is suitable for setting prices within the arm's length margin and EET Europarts' transfer pricing documentation is such that it can form the basis for an assessment of whether the product prices are set in accordance with the arm's length principle.*
>
> *The descriptions and analyses in the transfer pricing documentation, which are based on studies of market data from independent parties, support the chosen pricing methodology and document that the prices set are within the range of market prices that could have been paid if the transactions for the goods had been concluded between independent parties. EET Europarts has thus documented that the agreed prices are in accordance with the arm's length principle.*
>
> *However,* the Danish Tax Agency *has not documented that EET Europarts' pricing is not at arm's length, nor has* the Danish Tax Agency *documented that the determination of a "remuneration" of 2.5% is at arm's length.*
>
> The Danish Tax Agency*'s assumption is that EET Group A/S has had a loss on the trade with the sales companies during the case period is not correct. On the contrary, the pricing ensures solid earnings for EET Group A/S.*
>
> *In addition,* the Danish Tax Agency*'s method for determining a "remuneration" of the sales companies is specifically unsuitable for determining prices at arm's length conditions, because the method does not take into account the commercial realities of independent comparable companies in the market in which EET Euro-parts operates and therefore leads to arbitrary results.*
>
> *EET Europarts must therefore succeed in its claims that* the Danish Tax Agency*'s increases made in the decisions of July 8, 2016, must be set aside."*

The company has described how different products in the Group have different gross margins and how this affects the margins of the sales companies. Those of the Group's sales companies that sell a large proportion of high-margin products, [redacted], will therefore have a higher gross profit margin as a percentage of revenue than sales companies that predominantly sell lower margin products. Some sales companies will therefore - depending on the composition of the products sold

- have higher margins and earn more than other sales companies, even though all sales companies have the opportunity to buy the same products at the same prices from EET Group A/S.
Regarding the functions and activities of the sales companies, the company has stated the following:

"The sales companies are the "front line" of EET Europarts. The sales companies build, maintain, and develop the markets and thereby ensure the creation of the sales volume that is crucial to the group's success.

The sales companies set their own prices, and EET Group A/S is therefore not involved in the sales companies' pricing. This is described in the transfer pricing documentation for the income years 2010-2012 (Appendix 3, page 18, Appendix 4, page 19, and Appendix 5, page 18). It is also only the sales companies that have customer contact. The sales companies have access to and own their own customer lists, and they control their own marketing.

The sales companies also control their own costs. Firstly, it is up to the sales companies to decide whether they want to purchase goods from EET Group A/S or from another supplier, possibly directly from one of EET Group A/S' suppliers, see section 3.3 below. The sales companies thereby control their own consumption of goods.

Sales companies also control the number of employees, costs for salaries, office facilities, mileage and transportation, bookkeeping, auditing, IT and telephony, and local marketing costs. In this way, the sales companies control their own capacity costs.

The sales companies are thus autonomous entities that look after their respective self-interests.

This is reflected, among other things, in the fact that the remuneration of the sales companies' directors is partly dependent on the earnings of the sales company in question. This is also reflected in the fact that a number of the sales companies are partly owned by local management members. In these sales companies, the management thus has an extra incentive to ensure that the company achieves good results."

Regarding the sales companies' earnings at gross and net level, the company has described the following:

"The financial performance of the sales companies during the case period is highly variable, even though all sales companies can buy the same goods from EET Group A/S at the same prices.

The variations between the sales companies are due to a number of factors that also apply in the free market, including the fact that some of the sales companies are large and well-established companies with high turnover, which have benefited from the resulting economies of scale. Other of the sales companies were smaller and newer companies with lower turnover during the case period, which meant that a relatively high proportion of

earnings went to cover fixed costs and that some of the sales companies realized losses.

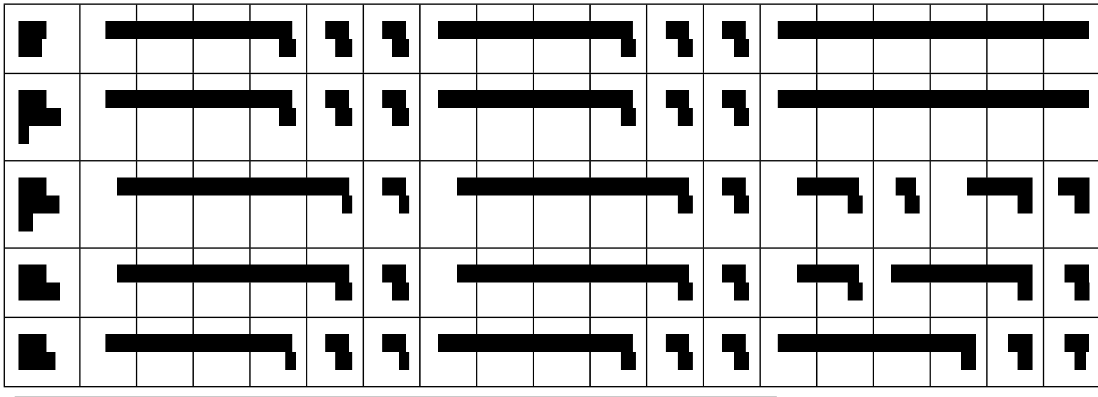
In addition, there are other factors such as differences in the competitive environment, the macroeconomic conditions and infrastructure in different country markets, the sales companies' sales of different high- and low-margin products and special customer agreements. Such factors also play a significant role for independent sales companies competing in the free market, as discussed further in section 5.3 below.

Notwithstanding these differences, EET Europarts' sales companies generally experienced growth in both revenue and earnings during the case period. The financial results of the sales companies are presented in the following.

In the ongoing assessment of the sales companies' performance, EET Europarts places great emphasis on a number of key figures, such as the individual sales company's turnover, gross profit, and gross margin, while EET Europarts places less emphasis on other key figures, such as the individual sales company's net profit and net margin.

This is because the net profits and net margins of sales companies are greatly influenced if it is a start-up sales company with relatively high-capacity costs in relation to a small volume or a well-established company with significant economies of scale, see below for more details."

The company has also submitted a supporting appendix to show the sales companies' key figures, based on the company's financial management system. The key figures show a different picture than the Danish Tax Agency's presentation of the key figures in the report:



The Company has then reviewed the background and reasons for the respective financial results for each sales company and summarized the following conclusions:

> *"As it appears from the review above, as well as from supporting exhibit 4, the financial results of the sales companies during the case period varied widely. The largest differences are found among the sales companies' net margins, which varied from approximately % of the highest earning sales companies to negative margins of the smallest and newest sales companies in the group.*
>
> *These significant differences cannot possibly be due to intra-group settlement prices, as EET Group A/S' prices were, as mentioned, equal for all sales companies.*
>
> *Instead, the review above shows that there is a clear correlation between sales companies' revenue, sales of high-end products, cost structure and net margins.*
>
> *The variations are due to the fact that some of the sales companies are large and well-established companies with high turnover that have benefited from the succeeding economies of scale. Other sales companies were smaller and newer companies with lower turnover, which meant that a higher proportion of their earnings went to cover fixed costs and thus that some sales companies realized negative net margins and losses.*
>
> *However, the general trend for EET Europarts' sales companies during the case period was increasing turnover and increasing earnings. In other words, the economies of scale in the EET Europarts Group have generally led to improvements in the earnings of the sales companies.*
>
> *Sales companies have full autonomy regarding the scope and composition of their capacity costs, including the number of employees, choice of expensive or cheap leases for sales offices, etc. Therefore, capacity costs also vary between sales companies.*
>
> *As mentioned, EET Group A/S offers all its products to all sales companies at the same prices.*

Thus, there is no link between the intra-group product prices (which are set by EET Group A/S and are the same for all sales companies) and the capacity costs of the sales companies (which are determined by each sales company).

On the other hand, there is a direct link between sales companies' capacity costs as a percentage of gross profit and sales companies' net revenue.

This is evident from supporting exhibit 4, which, as mentioned, shows that the sales companies with the highest turnover figures also achieved the highest net margins, while the sales companies with the lowest turnover figures also had the highest share of capacity costs as a percentage of gross profit and the lowest net margins among the sales companies.

This indicates that a significant part of the sales companies' capacity costs are fixed costs, which were more or less constant, even though the sales companies achieved an increasing turnover. In other words, the high net margins of some sales companies were not due to low internal transfer prices, but rather due to the economies of scale.

When one - such as the Danish Tax Agency - *use the sales companies' net margins (net profit divided by turnover) to investigate whether intra-group product prices are on market terms, the differences in the sales companies' turnover and capacity costs are therefore sources of error that can distort the results and give an overall picture that is not accurate. A comparison of the net margins of several companies will only be fair if adjustments are made for the differences in the companies' revenue and capacity costs.*

This is one of the reasons why EET Europarts has found it most appropriate to conduct the comparability analysis by comparing the gross margins of the sales companies with market data, and not by using the net margins of the sales companies as a basis for comparison, as the Danish Tax Agency *has done in the decision, cf. further details in sections 5.2 and 9 below"*

Regarding the comparability analysis made in the TP documentation, the company has stated the following:

"The comparability analysis is described in the transfer pricing documentation for each income year under the country documentation for each sales company (exhibits 3-5, section III, 4, b). It concludes that the intra-group product prices are within the market range ofprices at arm's length level.

After the end of the case period - and the completion of the four database studies - it is now possible to make an additional and extended comparison of the gross margins of EET Europarts' sales companies and the aggregated market data from all database studies, i.e., market data collected from all years from 2005 to 2013.

Such an extended comparison is presented graphically in supporting exhibit 5.

Supporting exhibit 5 shows the benchmark companies' gross margins in % in green and EET Europarts' sales companies' gross margins in % in blue.

The green lines between the green dots indicate that market data for the same benchmark company has been available in the Amadeus or Orbis databases for several years, and each line therefore expresses the development of one of the benchmark companies' gross margins. Similarly, the blue lines express the development of the individual sales companies in the EET Euro-parts group.

Firstly, the graphical overview shows that the gross margins of the benchmark companies (shown in green in exhibit 5) represent a very wide range. Thus, there has been no fixed level of market "remuneration" in any of the income years 2005-2013 - not even during the case period.

Secondly, it appears that the gross margins of EET Europarts' sales companies (shown in blue in supporting exhibit 5) were throughout the period within the - very wide - range of gross margins at market level documented by the database studies.

Exhibit 5 also shows that the total gross margins for all EET Europarts' sales companies were within the middle half (interquartile range from 10.40 % to 28.20 %, see table 29 in section 5.3.6 above) of the market range of gross margins documented by market data from the years 2010-2012. The interquartile range for 2010-2012 is framed in orange, while the interquartile range for all results from 2005-2013 is framed in purple.

The comparability analysis (shown in supporting exhibit 5) thus documents that EET Group A/S' intra-group product prices have helped ensure that the sales companies in the income years 2010-2012 have achieved gross margins that correspond to gross margins achieved by independent sales companies on the free market.

EET Europarts' transfer pricing documentation for the income years 2010-2012 thus documents that the intra-group trade in goods from EET Group A/S to the sales companies took place on market terms."

The company has subsequently described that the Danish Tax Agency has not been able to demonstrate in its decision that the prices used in connection with the inspected transactions do not comply with the arm's length principle. The Danish Tax Agency has only been interested in the earnings ratio (net margins) of the sales companies, and the Danish Tax Agency has made changes to the net margins for seven of the sales companies without taking into account the actual pricing of the intra-group transactions. The company therefore believes that the company's own database investigation documents that the intra-group handling of goods from EET Group A/S to the sales companies has taken place on market terms. However, the Danish Tax Agency has reached the opposite conclusion by only using these parts of the database investigation results as the basis for its decision, by editing the results of the sales companies,

and using these changed figures as a basis and thus significantly changing the method for the comparability analysis. According to the company, the Danish Tax Agency has thereby in its decision failed to base the assessment on an assessment of the actual controlled transactions at issue in the case. Instead, the Danish Tax Agency has changed the allocation of the group's total earnings - independently of the actual transactions - so that a larger part of the earnings in the case period accrues to EET Group A/S at the expense of the seven sales companies covered by the Danish Tax Agency's decision.

Regarding the Danish Tax Agency's criticism of the company's choice of method in the TP documentation, i.e. a comparison of the gross profits of the sales companies compared to the gross profits of the comparable companies, the company has stated that the Danish Tax Agency has not investigated whether there are any relevant differences in the accounting standards for the sales companies and/or for the benchmark companies. The Danish Tax Agency has not stated which companies would be affected by this or stated the numerical consequences of the alleged differences. The Danish Tax Agency has therefore not demonstrated that differences in accounting standards mean that a net profit-based method is more reliable than a gross profit-based method. Furthermore, the Danish Tax Agency has not documented that the company's calculations of gross profit are uncertain.
The fact that some of the gross margins are calculated by the company does not mean that the figures are unreliable. According to the company, the benchmark companies are comparable to EET Europarts' sales companies in that they are sales companies without significant research, development, production, or intangible assets. The companies' gross profits will therefore - all things being equal - correspond relatively precisely to the sum of each company's net profit and capacity costs, as calculated by the company itself. These assumptions used by the company thus have a high degree of certainty.

The company has also stated the following regarding the Danish Tax Agency's criticism that there should be differences in the benchmark companies' functions and activities and that the company should therefore have adjusted for this by, for example, applying a net profit-based test method:

> *"EET Europarts targeted its searches when preparing the database research and excluded those companies whose functions and activities were different from those of EET Europarts' sales companies.*
>
> *This selection process is described in detail in each database survey (exhibits 26, 27, 28 and 30) and is reproduced in section 5.3 above. Among other things, it appears that EET Europarts in the database survey for the income year 2010 (exhibit 26) only selected benchmark companies whose activities relate to the sale of computers, equipment and accessories for computers and electronic components.*
>
> *In addition, EET Europarts has excluded companies with (i) significant intangible assets, (ii) a stock exceeding 25% of turnover, (iii) production, development, or research and (iv) overhead costs exceeding 35% of turnover. EET Europarts then conducted a thorough manual screening of the remaining companies. The comprehensive and thorough selection*

process ensures that there are no "certain preconditions".

differences in functions and activities" between the benchmark companies and EET Europarts' sales companies.

Nor has the Danish Tax Agency *demonstrated that any of the 42 benchmark companies are not comparable to EET Europarts' sales companies, including in terms of functions and activities."*

The company has subsequently described that even if the Danish National Tax Tribunal finds that the company's TP documentation does not fully document that the intercompany transfer prices were at arm's length level, the Danish Tax Agency's decision must still be set aside. This is because the Danish Tax Agency's analysis is unsuitable for determining the arm's length terms in the case, and the Danish Tax Agency's decision is subject to a number of crucial deficiencies.

The company has stated that the Danish Tax Agency has incorrectly calculated the group's results and that the company therefore had no loss on the intra-group trade. The company justifies this in a number of accounting judgments, including, among other things, that the Danish Tax Agency includes the company's total cost base, which also includes the company's costs for the provision of services on arm's length terms to the sales companies. According to the company, this gives a distorted picture of the company's earnings on the intra-group sales of goods, which also include costs from other intra-group transactions. On this basis, the company has demonstrated that a correct calculation shows that the company actually realized a profit on the intra-group trade in goods.

The company has further stated that the Danish Tax Agency has incorrectly calculated the sales companies' earnings. According to the company, the Danish Tax Agency has calculated and used synthetic net profits and net margins, which in the Danish Tax Agency's opinion correspond to the sales companies' earnings on sales of goods purchased by the company. In this connection, the company has pointed out with reference to the Spanish sales company as an example that the Danish Tax Agency has not made a division between the sales companies' net profit relating to the sale of goods purchased by the company and the sale of goods purchased from independent suppliers. Thus, the Danish Tax Agency has not used the company's statements of the sales companies' net profits as a basis but has instead calculated the net profits from the intra-group trade in an artificial and non-representative manner.

The company has also described that the Danish Tax Agency's comparability analysis based on net margins is unsuitable in the case. According to the company, this is because the Danish Tax Agency's method is affected by differences in capacity costs:

"Capacity costs, also referred to as fixed costs, include a company's expenses for salaries, rent of premises, driving and transportation expenses, bookkeeping and auditing expenses as well as expenses for IT and telephony (cf. the Danish Business Authority's definition of the term "capacity costs" at www.virk.dk (exhibit 32)).

Capacity costs are not included in a company's gross profit (also called

the contribution margin), but they are included in the company's net profit (also called the contribution margin). The Danish Business Authority expresses it as follows (exhibit 32):

> *"When the capacity costs are deducted from the contribution margin, you arrive at the profit before financing costs and depreciation. Sometimes referred to as the contribution margin."*

This correlation can also be seen in the financial results for EET and EET in tables 16 and 20 in section 2.7 above, as well as in the supporting exhibit 4.

This shows that during the case period, EET had relatively low-capacity costs as a percentage of gross profit (%, % and 40 %), while EET on the other hand, had relatively high-capacity costs as a percentage of gross revenue (% and %). This was due to the fact that EET had a significantly higher turnover and that this volume created economies of scale, whereas EET was a newly established sales company during the case period, which still had high fixed costs in relation to its still modest turnover.

EET therefore generally had relatively high net margins during the case period %), while had negative net margins during case period).

Thus, capacity cost differences are not eliminated by measuring at net level, as claimed by the Danish Tax Agency. *On the contrary, by measuring at net level, capacity costs are included in the comparability analysis, and differences in capacity costs will cause the results to be distorted.*

This is a distortion of the results because the sales companies' capacity costs have nothing to do with the intra-group product prices.

As mentioned in section 2.6 above, the sales companies fully control their own operational costs, including the number of employees, salaries, office facilities, mileage and transportation, bookkeeping, auditing, IT and telephony and local marketing costs. These costs are completely independent of the intra-group product prices set by EET Group A/S.

The Danish Tax Agency*'s statements such as the correlation between gross margins, net margins and capacity costs are thus not correct.*

The Danish Tax Agency*'s decision contains no adjustments for this central source of error. On the contrary,* the Danish Tax Agency *has made some of the largest increases for sales companies with relatively high turnover and/or relatively low-*

Finally, the company has stated that the Danish Tax Agency's determination of an arm's length discount of 2.5% is unjustified. The company has justified this by stating that the Danish Tax Agency's use of the company's database survey at net profit level also shows a large spread between the net margins of the comparable independent benchmark companies. The Danish Tax Agency's statement

that there is no significant dispersion among the net margins of the benchmark companies is therefore contrary to the results of the database study. Since the Danish Tax Agency has not demonstrated that any of the benchmark companies are not comparable with the group's sales companies, all the results of the database study can therefore be used as market-related net margins for independent benchmark companies. Subsequently, the company has concluded the following:

> *"When this wide market range of net margins (from -7.2% to 26.3%, see exhibit 30, page 1) is compared to the range of net margins of EET Europarts' sales companies (from -21.2% to 10.5%, see exhibit 14 and supporting exhibit 4), it appears that the net margins of EET Europarts' sales companies are generally similar to the net margins of comparable, independent benchmark companies"*

Subsequent posts

The Danish Tax Agency's submission of June 25, 2018

The Danish Tax Agency has submitted a consultation response to the company's letter of complaint. In this connection, the Danish Tax Agency has not found that there is any new factual information in the companies' complaint that can justify a change in the Danish Tax Agency's decision, and therefore upholds the decision of July 8, 2016, in its entirety.

The Danish Tax Agency has noted that the company itself in its TP documentation has described the sales companies as "low risk" distributors. The company's claim that the sales companies had more risks than stated by the Danish Tax Agency, the Danish Tax Agency believes is an expression of post-rationalization and based on a later prepared distribution agreement effective from 1 January 2014:

> *"In this connection,* the Danish Tax Agency *maintains that the company itself has described the sales companies as "low-risk distributors" in the TP documentation for the income years in question, which is why* the *Danish Tax Agency has taken this as the basis for the decision. The fact that the company subsequently, in both the objection to the Danish Tax Agency's proposed decision, in the TP documentation for the income year 2014 and in a later prepared distribution agreement, changes the classification to "limited risk distributors" does not change the fact that the Danish Tax Agency in its decision has based its decision on what the company itself has stated in the TP documentation for the income years in question. The material was prepared subsequently and bears the mark of post-rationalization by the company, and material prepared subsequently should therefore not be given importance.*
>
> *The Danish Tax Agency's assessment is also supported by the fact that the country-specific TP documentation states that it is possible to make "year-end adjustments" between EET Group A/S and the sales companies, which is why the risk is transferred from the sales companies to EET Group A/S. The fact that no use has been made of "year-end adjustment", neither in the case period nor subsequently, does not change the fact that it is a possibility, which is why EET Group NS must necessarily be considered to be the company that bears the most significant risks."*

Regarding the choice of method, the Danish Tax Agency has stated that the sales companies are characterized by the company itself as "low-risk" entities or as "limited-risk" entities without intangible assets. Both the company and the Danish Tax Agency agree that the sales companies are tested parties in the intra-group transaction and are thus the simple party. The TNM method is suitable for testing whether the intra-group transaction between a simple party and the party owning intangible assets is in accordance with the arm's length principle. In this connection, the Danish Tax Agency has referred to the fact that the OECD Transfer Pricing Guidelines prescribe that measurement is made at net profit level. Furthermore, the Danish Tax Agency has stated that differences in products and functions affect the gross profit far more than they affect the net profit, and that the net profit on the present basis is therefore a more reliable measure than the gross profit.

Regarding the sales companies' purchases from external suppliers, the Danish Tax Agency has noted that the company has not segmented the sales companies' turnover in relation to internally and externally purchased goods. The Danish Tax Agency has therefore used the information that the Danish Tax Agency was in possession of at the time of the decision. The company has therefore not, in the Danish Tax Agency's opinion, demonstrated that the Danish Tax Agency's calculation is incorrect or otherwise produced the necessary segmentation for the sales companies' turnover. The Danish Tax Agency has therefore only made this division for the [redacted] sales company where the information was available.

Regarding the determination of the arm's length interval as either full range or interquartile range, the Danish Tax Agency has stated the following:

> *"The Danish Tax Agency has, both in the Danish Tax Agency's decision and above, explained that there are significant shortcomings in the company's functional and comparability analysis, which is why the comparability with the benchmark companies is not fully illustrated.*
>
> *It is therefore the Danish Tax Agency's assessment that the company cannot use full range as an arm's length interval. The Danish Tax Agency therefore maintains that interquartile range should be used instead, as interquartile range increases comparability by only including the results from the middle 50% of the comparable benchmark companies. This is supported by TPG 3.57.*
>
> *Reference is also made to the Danish Tax Agency's legal guidance (CD.11.5.9) which states the following.*
>
> > *"When using database studies, the comparability factors of the independent transactions and business activities are rarely fully elucidated.*
> >
> > *Therefore, when interpreting the result obtained from the database search, statistical methodology is used to minimize the significance of unidentified differences between the transactions and the business activities.*
> >
> > *In database studies in relation to the margin-based methods, only the*

observations that lie in the middle interval (interquartile range - IQR) used in determining the arm's length earnings of the tested party."

The Danish Tax Agency has then illustrated in a table the gross margins of the sales companies and the results from the benchmark studies for the income years 2010, 2011 and 2012 and indicated which gross margins are above or below the interquartile range.

The company's submission of November 8, 2018
In its submission, the company maintains that the Danish Tax Agency's consultation letter does not give reason to change the claim made by the company.

The company has summarized why the pricing method used by the company is suitable for setting prices within the arm's length range:

"In relation to the sales of goods from EET Group A/S to the sales companies, EET Europarts uses a pricing based on the Cost-Plus method.

On this basis, EET Group A/S offers all its more than 400,000 water types to all sales companies and on the same terms, cf. for example the post of January 17, 2018, sections 3.1 and 4.

In other words, the product is sold on the same terms regardless of whether the product is sold to a sales company in Norway, Sweden, Italy, Finland, the Netherlands, Spain, or the UK), or whether it sold to a sales company in France, Germany, Switzerland, Czech Republic, Austria, or Poland).

The sales companies' varying earnings cannot therefore be due to the intra-group transfer prices, but are instead justified by other factors, including the competitive situation, economies of scale, macroeconomic conditions and infrastructure in the different countries' markets, the age, size and cost structure of the sales companies, the sale of high-end products and the conclusion of advantageous agreements with independent customers"

The company has further stated that the Danish Tax Agency's view that the gross margins for certain of the sales companies in 2012 exceeded the highest gross margins among the benchmark companies is based on a comparison between the gross margins for the sales companies at product category level and the combined gross margins of the benchmark companies (i.e. without regard to product categories). In addition, the company has further described that the comparison of gross margins must necessarily be made at a similar level for the group's sales companies and the benchmark companies, which means that the relevant basis of comparison must be the combined gross margins for the sales companies and the combined gross margins for the benchmark companies. When compared on this correct basis, the gross margins for the sales companies do not differ from the gross margins of the benchmark companies, as the combined gross margins for all sales companies were within the middle half (interquartile range) of the market range of gross margins documented by

market data from the years 2010-2012. The company has then concluded that the comparability analysis thus documents that the consolidated product prices have helped ensure that the sales companies in the years 2010-2012 have achieved gross margins that correspond to gross margins achieved by independent sales companies on the free market.

The Danish Tax Agency's consultation response to the Danish Tax Appeals Agency's recommendation

The Danish Tax Agency has submitted a consultation response to the Danish Tax Appeals Agency's recommendation on August 30, 2019. In the consultation response, the Danish Tax Agency states that it does not agree that the increase in the sales companies' earnings must be made at gross profit level.

The Danish Tax Agency has stated that it does not disagree that certain product differences can be accepted when applying the Resale Price Method (comparison at gross profit level), as stated by the Danish Tax Appeals Agency. However, the Tax Agency has further described that comparability also depends on whether the functions performed are comparable in terms of both assets spent and risks assumed. According to the Danish Tax Agency, the company itself has stated that there is a difference in the activities related to the sale of OB and OEM products, respectively. This is also supported by the fact that in connection with the comparability analysis in their TP documentation, the company has chosen to divide the products into OB and OEM

The Danish Tax Agency has therefore maintained that the comparability analysis has not been sufficiently adjusted for differences in functions and products, which is why comparability at net profit level will provide a more reliable result, as differences in functions and products affect gross profit far more than net profit.

In summary, the Danish Tax Agency has described as follows:

> *"The Danish Tax Agency does not agree that differences in functions and products have been sufficiently assessed in connection with the comparability analysis or otherwise explained that the differences should not be given importance. The Danish Tax Agency maintains that in connection with the segmentation of the sales companies' profits, the differences in the product groups (OB and OEM) must be taken into account, that comparison at net profit level will minimize the uncertainties and that the sales companies' profits should be weighted differently for the two product groups and not weighted equally, as is the case in the Tax Agency's recommendation"*

Furthermore, the Danish Tax Agency has described that it does not agree with the recommendation that only an exclusion of companies with booked intangible assets and companies with a certain storage capacity sufficiently compensates for the differences that may exist between the sales companies and the comparable companies. In this connection, it is pointed out that the company in its TP documentation has stated that none of the sales companies have their own warehouse, but that the company in the objection of November 20, 2015, has stated that the sales companies in Norway and Spain have a local stock and

thereby assuming an inventory risk. Furthermore, it is pointed out that the company's benchmark study for 2010 and 2011 includes companies with inventories of between 5-25% of revenue, whereas the company's benchmark study for 2012 only includes companies with a weighted inventory of less than 3.5%. The company has thus changed the selection criteria in the benchmark studies, which means that companies included in one benchmark are excluded in the other.

The Tax Agency has also stated that in their benchmark study for 2008-2010 the company has used 5 benchmark companies (out of 10) with booked intangible assets, even though EET's sales companies have not booked intangible assets. In summary, the following is described:

> *"Against this background, it can be stated that the company is not consistent in the information provided on inventories in the sales companies, that there is a change in the selection criteria during the period, which is not explained by the company, and that the inventories in the Norwegian and Swedish sales companies are not in accordance with the selection criteria, so it is questionable whether the companies included in the benchmark studies are comparable"*

The Tax Agency has further described the following regarding differences in accounting standards and arm's length interval:

> *"In its recommendation, the Danish Tax Appeals Agency has also emphasized that any differences in accounting standards between the sales companies and the comparable companies will have less impact on the arm's length interval, as data from a significant number of companies are included, which is why such adjustments will have less impact on the interval as a whole.*
>
> *The stated view is not stated in the OECD Transfer Pricing Guidelines 2017 in the section on Resale Price Method, which the Danish Tax Appeals Agency refers to. However, it is clear from OECD Transfer Pricing Guidelines 2017, paragraph 2.41, that differences in accounting standards must be adjusted for in the comparability analysis:*
>
>> *"Where the accounting practices differ from the controlled transaction to the uncontrolled transaction, appropriate adjustment should be made to the data used in calculating the resale price margin in order to ensure that the same type of costs are used in each case to arrive at the gross margin. For example, costs of R&D may be reflected in the operating expenses or in costs of sales. The respective gross margins would not be comparable without appropriate adjustments" (The Danish Tax Agency's underlining)*
>
> *The company's benchmark study for 2010-2012, section 2.5.1, shows that if there is no gross profit for the comparable companies, this is calculated by deducting Material Costs from revenue.*
> *The company has previously prepared and submitted a statement of how the benchmark companies' gross margins are calculated in the benchmark study for the 2012 income year. The statement shows that all benchmark companies'*

gross results are calculated by deducting Material Costs from turnover. The Danish Tax Agency has looked up the benchmark companies for the benchmark study for 2008-2010 in the Amadeus database and found that the same applies to the benchmark studies 2008-2010.

On page 7 of EET Europarts A/S' (Danish sales company) annual accounts for 2012 (Appendix B) it appears that gross profit includes net turnover, cost of sales and other external costs, which is also supported by EET Europarts A/S' calculation of taxable income for the 2012 income year. Gross profit is thus calculated as revenue minus cost of sales minus other external costs.

EET Sales companies	***Benchmark companies***
Turnover	*Turnover*
- Cost of goods sold	*- Material Costs*
e - Other external om-	***=Gross profit***
=Gross profit	*- Other external costs*
k - Personnel costs	*- Staff costs*
a - Depreciation and amortization	*- Depreciation and amortization*
- Other costs	*- Other costs*
=EBIT	***=EBIT***

It can thus be seen that the gross profit for the benchmark companies and EET's sales companies are calculated in different ways.

In this connection, it should also be added that the company's auditor (KPMG) in the interim reports for the 2011- and 2012-income years (exhibits K and L) has stated that no accounting manual has been prepared for the group, which is why there is a risk that the individual subsidiaries handle accounting matters differently. This creates further uncertainty about the gross profits applied.

The Danish Tax Agency has also found that there are differences in the gross profit of the Danish, Norwegian and Swedish sales companies depending on whether you look at the company's transfer pricing documentation or the sales companies' annual accounts. The same applies if you look at the turnover of the Norwegian sales company. The Danish Tax Agency has not had the opportunity to review the other sales companies' annual accounts, so it cannot be ruled out that the same applies to several of the group's sales companies.

In this regard, it should be noted that no significant differences have been found at EBIT level. In the decision, the tax authorities have applied the TNM method, where the comparison is made at EBIT level."

Finally, the Danish Tax Agency has pointed out that with the Danish Tax Appeals Agency's recommendation and calculation method, several of the sales companies will achieve negative EBIT margins for the 2012 income year, while with the Tax Agency's decision they will achieve a fixed EBIT of 2.5%. Negative EBIT margins would be in direct contradiction with the company's classification of

the sales companies as low-risk distributors without risks and furthermore, these negative results are inconsistent with the selection criteria used by the company in their 2010 and 2011 benchmark study.

The complainant's response to the Danish Tax Appeals Agency's recommendation

The complainant has, through its representative, submitted a response dated December 19, 2019. The submission maintains the claim that the Tax Agency's increases for the income years 2010-2012 should be reduced to 0.

In its submission, the company has described that it agrees with the Danish Tax Appeals Agency that the TP documentation provides a sufficient description of the controlled transactions and that the Danish Tax Agency therefore has a double burden of proof, as the Danish Tax Agency must prove that the company's pricing is not at arm's length and that the Danish Tax Agency's corrected results are at arm's length. The company does not believe that the Danish Tax Agency has done so.

Regarding the comparison of the financial results at the gross profit level, the company has stated that it agrees with the Danish Tax Appeals Agency that an analysis at the gross profit level is specifically the most accurate method because the company sets its prices according to the cost plus method, which is based on gross profit, and because a gross profit-based method comes closer to the intra-group transactions under review, thereby avoiding a number of the sources of error that exist in net profit-based methods. Furthermore, in preparing the database studies, the Company has adequately considered any differences in functions, products, intangible assets, inventory, and accounting standards. Regarding the product breakdown, the company has agreed with the Danish Tax Appeals Agency that the gross margin of the sales companies must be considered in total for all product categories, as no breakdown of gross margins by product category has been made for the comparable companies either.

On the issue of the application of selection criteria, including inventory and intangible assets, the company has described the following:

> *"In its statement of August 30, 2019, pages 4-5, the Danish Tax Agency has pointed out that there is not a 100% precise coincidence between the selection criteria for the independent benchmark companies on the one hand and EET Europarts' sales companies on the other hand. Thus, EET Europarts has accepted in the data base studies that some of the independent benchmark companies have limited inventory and an insignificant level of intangible assets (up to 5% of turnover), although most of EET Europarts' sales companies have neither inventory nor significant intangible assets.*
>
> *The two sales companies in the EET Europarts Group with their own inventory are EET Spain and EET Norway.*

As described in the submission of January 17, 2018, page 27, EET Spain has its own local warehouse and local distribution due to the local infrastructure and the desire to deliver goods quickly to the Spanish market. An extract from EET Group A/S' financial management system with information about EET Spain's inventory is presented as exhibit 33. This shows that EET Spain's inventory amounted to 3.5 % and %, 4.1 % and 5.0 % of revenue in the income years 2010-2012.

EET Norway's inventory was, as mentioned in the Danish Tax Agency's statement of August 30, 2019, pages 4-5, quite modest with 4.60%, 4.30% and 6.10% of turnover in the income years 2010-2012, respectively. The products belonged, among other things, to the categories ██████ Pro██ of the brand ██ purchased by EET Norway from independent external suppliers, cf. the submission of January 17, 2018, page 24.

It is therefore correct that there are minor differences in inventory levels between some of EET Europarts' sales companies on the one hand and some of the independent benchmark companies on the other.

However, it should firstly be noted that transfer pricing is not an exact science and that it is often not possible to find independent benchmark companies that are 100% comparable. EET Europarts has therefore chosen the search criteria that best matched EET Europarts' sales companies at the time of the preparation of each database search, while ensuring that the search criteria resulted in an appropriate number of benchmark companies. In this regard, it is important that all the resulting benchmark companies underwent quantitative and qualitative screening before they were finally selected.

Secondly, it should be noted that the differences pointed out by the Tax Agency are of a limited scope. EET Europarts has excluded all companies with significant inventory or intangible assets from the database searches, and the remaining benchmark companies provide the best possible basis for the comparability analysis. The Danish Tax Agency has not identified a single benchmark company that, in its opinion, should be excluded from the comparability analysis.

EET Europarts' choice of search criteria is therefore not "unfounded and paradoxical" as stated by the Danish Tax Agency in the opinion of August 30, 2019, page 5, first paragraph, but is rather an expression that EET Europarts has chosen search criteria that provide the most relevant results based on the available data."

Regarding the differences in accounting standards, the company has stated that when preparing the comparability analysis, the company has not used the gross results calculated in the sales companies' annual reports, which the Danish Tax Agency has emphasized, and which are burdened by other external costs. The company has used gross results for the sales companies that are not burdened by other external costs and are therefore calculated in the same way as the gross results for the benchmark companies. This is evident from the TP documentation. The Tax Agency's assumption that the company's comparability analysis is distorted by extraneous costs is thus not correct.

Regarding the actual basis for the comparability analysis, the company has described the following two disagreements with the Danish Tax Appeals Agency:

> *"Although the Danish Tax Appeals Agency agrees with EET Europarts that the comparative analysis should generally be performed using a gross profit-based method, the Danish Tax Appeals Agency has nevertheless proposed significant increases in the taxable income for EET Group A/S.*
>
> *This is because the Danish Tax Appeals Agency has not compared EET Euro-parts' sales companies with all the independent benchmark companies, but instead only with a small part of the benchmark companies.*
>
> *Thus, the Danish Tax Appeals Agency has - like the Danish Tax Agency in the appealed decision - failed to include most of the independent market data presented by EET Europarts in the case in the comparability analysis. This is due to two separate choices.*
>
> *Firstly, for each income year in the case (2010-2012), the Danish Tax Appeals Agency has only included data from the database study that EET Euro- parts has attached to its TP documentation for the income year in question. The Danish Tax Agency has thereby disregarded the other database studies and has conducted three separate tests with a limited amount of market data.*
>
> *It is EET Europarts' view that EET Europarts' sales companies should be tested against the benchmark companies from all four database studies in an overall test including all market data presented in the case, as elaborated in section 3.2 below.*
>
> *Secondly, the Danish Tax Appeals Agency has only included the middle half (interquartile range) of the market range of gross margins and has thus failed to include half of the independent benchmark companies' results.*
>
> *It is EET Europarts' view that all benchmark companies' results should be included in the comparability analysis, which is elaborated in section 3.3 below.*
>
> *If the Danish National Tax Tribunal agrees with EET Europarts in just one of these choices, this means that the gross margins for all EET Europarts' sales companies are within the market range of gross margins for independent benchmark companies."*

The Company is of the opinion that all database studies must be taken into account when determining the arm's length intervals, including the database study prepared after the Tax Agency's decision in connection with the appeal. The results of this database study are new information in the sense that they were not available at the time of the tax audit, but were only presented during the appeal case, and the information is also relevant to the decision in the appeal case. The Tax Agency, the Danish Tax Appeals Agency and the Danish National Tax Tribunal are therefore obliged to consider such new information when assessing the case. When all

market data from the four database surveys are pooled, it appears that the total gross margins of all the group's sales companies are within the market range, even within the middle half (interquartile range).

Finally, the company has argued that it disagrees that the arm's length interval from the results of the database survey constitutes the interquartile range. Section 2 of the Danish Tax Assessment Act does not state that such statistical methods can be used, nor has the Danish Tax Agency demonstrated that any of the 42 benchmark companies are not comparable with the group's sales companies. All the results of the database studies - not just the interquartile range - can thus be used as objective market data for comparable independent companies. In addition, the company has attached a statement from a professor of actuarial mathematics, who states that a narrowing to the interquartile range is highly unconventional and that the starting point is to apply a so-called significance level of 5%, which excludes a significantly smaller part of the results. The professor therefore concludes in the report that narrowing to the interquartile range gives a high risk of incorrect results.

The Danish National Tax Tribunal's decision

When calculating taxable income, affiliated companies must use prices and terms for commercial or financial transactions (controlled transactions) in accordance with what could have been achieved if the transactions had been concluded between independent parties. This follows from section 2, subsection 1 of the Danish Tax Assessment Act. The arm's length principle in the provision must be interpreted in accordance with Article 9(1) of the OECD Model Tax Convention, the OECD Commentary thereto and the OECD Transfer Pricing Guidelines.

According to section 3 B, subsection 5 of the Danish Tax Control Act as it stood at the time, group companies were obliged to prepare and keep written documentation of how prices and terms were determined for the controlled transactions. The documentation was to form the basis for an assessment of whether prices and terms complied with the arm's length principle, and it was to be submitted to the Danish Tax Agency upon request, cf. Executive Order no. 42 of January 24, 2006.

At the Danish Tax Agency's request, the company has submitted TP documentation for the income years 2010-2012 in which the Group's controlled transactions are described.

The Danish Tax Agency has made a correction of the company's taxable income for the income years 2010-2012 with reference to section 2 of the Danish Tax Assessment Act. It is then incumbent on the Danish Tax Agency to prove that prices and terms have not been in accordance with the arm's length principle and that a correction pursuant to section 2, subsection 1 of the Danish Tax Assessment Act has therefore been justified.

In connection with the correction, the Danish Tax Agency has rejected that the company's comparability analysis can be performed at gross profit level. The Danish Tax Agency justifies this by stating that differences in accounting standards are not taken into account, that there is no available data on gross profits at the

comparable companies, and that synthetic gross margins have therefore been calculated, and finally that there are large differences in the operating cost intensity of the comparable companies, for which should have been adjusted. However, the Danish Tax Agency agrees with the company's choice of comparable companies and then calculates an arm's length interval and a median at net profit level for the income years 2010-2012 for the comparable companies.

The Danish National Tax Tribunal finds that a comparison of the gross profits of the sales companies in relation to the gross profits of the comparable companies selected by the company has rightly been used in the company's TP documentation as the basis for the arm's length analysis, see OECD Transfer Pricing Guidelines 2017, paragraphs 2.27-2.41. Emphasis has been placed on the fact that the sales companies' main activity is distribution of a number of standard products, and that product differences can therefore be accepted in the analysis, cf. OECD Transfer Pricing Guidelines 2017, para. 2.30. Any differences in functions performed between the sales companies and the comparable companies have, in the opinion of the Danish National Tax Tribunal, been sufficiently taken into account by applying the selection criteria of excluding comparable companies with booked intangible assets and excluding companies with a certain storage capacity, cf. OECD Transfer Pricing Guidelines 2017 points 2.32 and 2.33. It is also the opinion of the Danish National Tax Tribunal that any differences in accounting standards between the selling companies and the comparable companies will have less impact on the arm's length interval, as the interval includes data from a significant number of companies and therefore such adjustments will have less impact on the interval as a whole. Furthermore, it is the opinion of the Danish National Tax Tribunal that the company's calculations of gross profits in cases where there has been no available data on gross profits for the comparable companies cannot in itself justify a rejection of the method as a basis for the arm's length assessment. The company has made calculations of gross profits that can be included in the comparability analysis with sufficient certainty.

The company has prepared database studies for the respective income years and concluded that since the gross margins of the sales companies are within the full range of the database studies, trading is at arm's length.

The Danish National Tax Tribunal finds that the arm's length intervals, as used by the company itself in its TP documentation, cannot constitute the full intervals for the comparable companies' key figures, but must be narrowed down to the interquartile ranges, cf. OECD Transfer Pricing Guidelines 2017 section 3.57. It is emphasized here that the selected companies are sufficiently comparable with the sales companies' functions, assets, and risks in terms of the choice of methodology, but that certain comparability deficiencies will occur in data surveys, as the selected comparable companies cannot be considered perfectly comparable with the sales companies. This is taken into account by using statistical methods such as interquartile ranges. It should be noted that the use of interquartile ranges as arm's length ranges follows from common practice when using database studies in the transfer pricing area, and the method

is also, as the only statistical method, mentioned in the OECD Transfer Pricing Guidelines 2017, section 3.57.

The Danish National Tax Tribunal thus finds that the income for the respective sales companies, whose gross profit lies outside the interquartile ranges for the individual income years 2010, 2011 and 2012, as they appear from the company's own TP documentation for the individual years, must be adjusted to the nearest point in the arm's length interval, i.e. the third quartile. In this respect, the Danish National Tax Tribunal refers to the fact that the sales companies perform distributor functions that are functionally comparable to the selected companies within the arm's length interval, and that the Danish Tax Agency has not proven that the companies within the arm's length interval do not have earnings on arm's length terms.

The Danish National Tax Tribunal also finds that the sales companies' gross profit must be considered in total for all product categories, as income is not broken down by product category for the comparable companies either. It is also noted that the database studies used by the company itself as the basis for the TP documentation for the individual income years constitute the most suitable basis for determining the arm's length intervals, as these data have formed the basis for the companies' own arm's length tests in connection with the pricing.

The adjustment will thus be as follows:

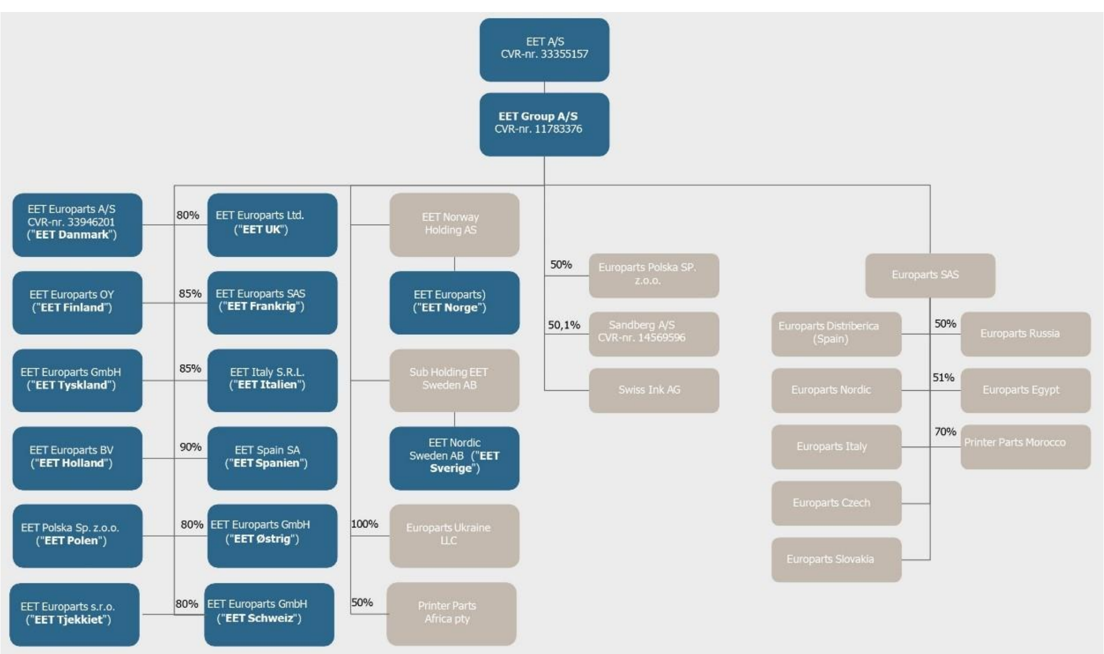
In the income year 2010, all sales companies' gross profits are within the arm's length interval and the Danish Tax Agency's increases are therefore reduced to 0.

In the 2011 tax year, gross margins for the sales companies in [redacted] and [redacted] above the arm's length range (third quartile at 22.6%) and these gross margins profits are therefore adjusted to the third quartile in the company's comparability analysis (22.6%). The Danish National Tax Tribunal therefore sets the increase to a total of DKK 2,670,294 (DKK 2,245,440 for the [redacted] sales company and DKK 424,854 for the [redacted]).

In the 2012 income year, the gross margins for all sales companies, apart from the German company, are above the arm's length [redacted] (third quartile of 15.9%), and these gross margins are therefore adjusted to the third quartile in the company's comparability analysis (15.9%). The Danish National Tax Tribunal therefore sets the increase at a total of DKK 26,916,841 (DKK 3,454,205 for the [redacted] sales company, DKK 2,827,944 for the [redacted] sales company, DKK 1,201,140 [redacted] for the sales company, DKK 2,034,858 for the [redacted] sales company, DKK 5,937,010 for the [redacted] sales company, DKK 3,852,146 for the [redacted] sales company, DKK 2,860,898 for the [redacted] sales company, DKK [redacted] for the [redacted] sales company, DKK 2,026,248 for [redacted] the sales company, DKK 126,298 for the [redacted] sales company, DKK 345,677 for the [redacted] sales company and DKK 178,269 for [redacted] the sales company). It is noted that in addition hereto that the gross profit in the [redacted], [redacted], [redacted], [redacted] and [redacted] sales company has been adjusted proportionally in relation to the company's calculation of the share of intra-group purchases in relation to total purchases, cf. the company's calculation in the complaint of January 17, 2018, page 37."

Additional information

It appears from the information in the case, including the Danish Tax Agency's decision of July 8, 2016 and the Danish National Tax Tribunal's decision of October 28, 2020, that EET Group was the operational part of the EET Group, which during the case period was one of Europe's largest niche distributors of products within video surveillance, spare parts and accessories for computers, printers, tablets and mobile phones. EET Group provided back-office services for the entire group, including order management, IT, and accounting processes. The group's senior management was also employed by the company, which also provided management services throughout the group. EET Group also purchased, developed, marketed, and sold electronic components and had legal ownership of the warehouse, which it also managed. The structure of the EET Group as of December 31, 2012, was as follows:

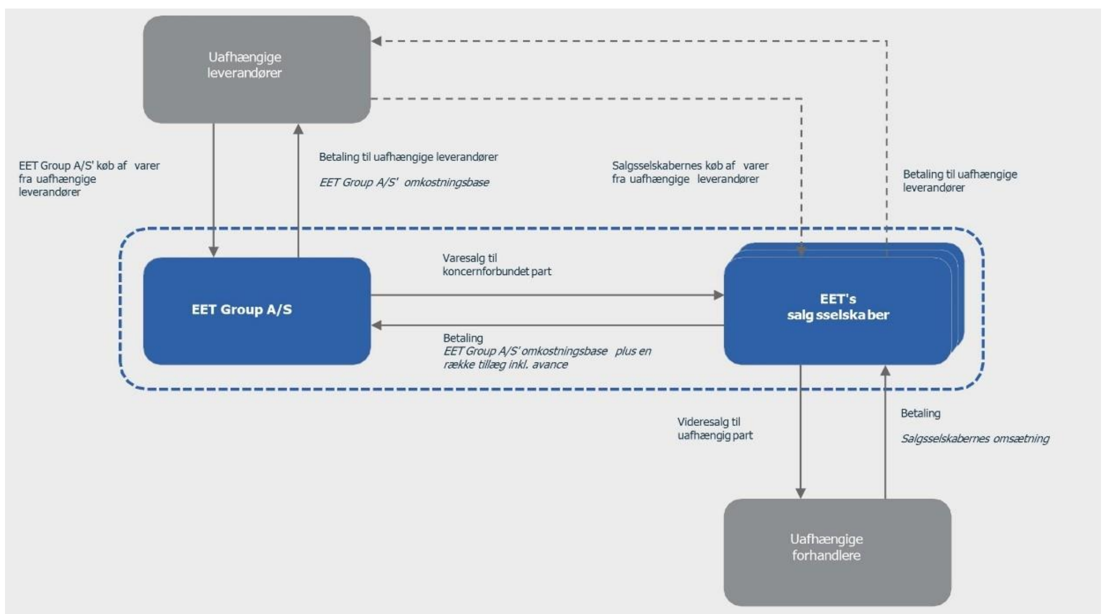


The company purchased two types of products for resale, including:

1. Generic electronic components such as branded HP, Lex- mark, Digital and Axis as well as electronic components that were not considered branded. These products are referred to as Original Equipment Manufacturer (OEM for short).
   Semi-manufactured electronic components that were assembled into branded products ([redacted]). These products are referred to as Own Brands (OB for short). The semi-manufactured products were branded by EET Group.

The EET Group's sales organization was structured in such a way that the Group had a number of subsidiaries responsible for the sales and marketing of the EET Group's products in their respective territories (the Sales Companies).

The sales companies purchased the above products from EET Group, which were resold to customers external to the group. Some of the sales companies also purchased products from outside the group, which were also resold to customers outside the group. The EET Group has sought to illustrate the buying and selling in the following way:



The EET Group has had the following financial results during the period:

EET Group financial results ('000 DKK)	Income year 2010[1]	Income year 2011 (18 months)[2]	Income year 2012[2]
Net revenue	627,842	1,245,222	1,036,090
Gross profit	21,954	41,448	80,536
Gross margin[3]	3.50 %	3.33 %	7.77 %
Profit from ordinary operations (EBITDA)	7,782	22,961	16,023
Profit before financial items (EBIT)	6,310	17,137	11,098
Net margin[4]	1.00 %	1.38 %	1.07 %

[1] Source: EET Groups A/S' annual report for 2010/11.
[2] Source: EET Group A/S' annual report for 2012.
[3] Source: Calculated by taking gross profit in relation to net sales.
[4] Source: Calculated by taking EBIT in relation to net sales.

The performance of the entire EET Group is as follows:

EET Group financial results ('000 DKK)	Income year 2010[1]	Income year 2011 (12 months*)[2]	Income year 2012[2]
Net revenue	971,634	1,217,510**	1,427,204
Gross profit	190,172	248,878	279,286
Gross margin[3]	19.57 %	20.44 %	19.57 %
Profit from ordinary operations (EBITDA)	75,092	108,270	111,751
Profit before financial items (EBIT)	64,402	78,558	76,260
Net margin[4]	6.63 %	6.45 %	5.34 %

Profit for the year	41,884	37,635	26,474
Consolidated net result	33,991	35,153	24,342

* The results in the income year 2011 (financial year 2010/11) have been converted from 18 to 12 months.
** Total revenue in the extended financial year amounted to approximately DKK 1,751 million.
[1] Source: EET Nordic Group A/S' annual report for 2009/10.
[2] Source: EET A/S' annual report for 2012.
[3] Source: Calculated by taking gross profit in relation to net sales.
[4] Source: Calculated by taking EBIT in relation to net sales.

Transfer pricing documentation

At the Danish Tax Agency's request, EET Group has submitted transfer pricing documentation for the income years 2010-2012.

It appears from the documentation that EET Group considered five different transfer pricing methods when preparing the documentation. Of the five methods, four, i.e., the comparable uncontrolled price method, the resale price method, the cost-plus method, and the profit split method, were deemed unsuitable for testing whether EET Group's sales to the EET sales companies had been made on arm's length terms. According to the transactional pricing documentation, EET Group instead chose to apply the transactional net margin method for the following reasons:

> "The TNMM examines the net profit relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realizes from a controlled trans- action. As pointed out in the OECD Guidelines paragraph 2.59, a TNMM hence operates in a manner similar to the resale price method, and this similarity means that to be applied reliably, the TNMM must be applied in a manner consistent with the manner in which the resale price method is applied.
>
> For purposes of applying the TNMM, relevant data from EET-AT's management accounts is aggregated into gross profits for own brands and for generic products, respectively, and comparable external gross margins are used for comparison. Thus, a substantially comparable set of independent pan-European distributors, performing broadly similar functions and incurring broadly similar risks as those of the sales activities performed by EET-AT, as supported by the functional analysis, was conducted."

For the transfer pricing documentation, EET Group has prepared database studies to find comparable independent companies whose earnings can be compared with the Group's sales companies.

The database study for the income year 2010 was prepared with assistance from Deloitte and using accounting data from the period 2005-2007. A quantitative and qualitative screening of companies was carried out.

In the quantitative screening, the number of potential benchmark companies was narrowed down from approximately 1.5 million companies to 335 companies using a number of selection criteria. As an included criteria the companies could not have intangible assets corresponding to more than 5% of the company's turnover or an inventory of more than 25% of turnover.

The qualitative screening, which consisted of a manual review of information regarding the 335 companies accepted after the quantitative screening, narrowed the number of companies down to 16.

The ranges for the 16 selected companies' gross margins are described in the documentation as follows:

Minimum	**Lower quartile**	**Median**	**Upper quartile**	**Max.**
7.79 %	11.90 %	16.40 %	24.44 %	37.04 %

At the request of the Ministry of Taxation, EET Group has prepared a supplementary database study for the income year 2010, using market data from 2007-2009.

In preparing the supplementary database study, a quantitative and qualitative screening of companies was again carried out. In the quantitative screening, the number of potential benchmark companies was narrowed down from approximately 15 million companies to 132 companies. The qualitative screening, which consists of a manual review of information regarding the 132 companies accepted after the quantitative screening, narrowed the number of companies down to 9 companies.

The ranges for the gross margins of the 9 selected companies are as follows:

Minimum	**Lower quartile**	**Median**	**Upper quartile**	**Max.**
9.04 %	12.35 %	16.71 %	26.86 %	32.19 %

For the transfer pricing documentation for the 2011 income year, EET has, with the assistance of KPMG, updated the accounting figures for the selected companies in the database survey for 2010 so that accounting figures for the period 2008-2010 are used.

When the database survey was updated for the 2011 tax year, data was available for the financial years 2008-2010 and of the 16 independent companies identified in the 2010 database survey, 10 of the 16 companies had updated information in the database.

The ranges for the gross margins of the selected companies are described in the documentation as follows:

Minimum	Lower quartile	Median	Upper quartile	Max.
9.2 %	17.6 %	20.1 %	22.6 %	34.5 %

The database survey for the 2012 income year is a new database survey (and thus not a financial update of a previous database survey) conducted with the assistance of KPMG. The survey was conducted among more than 3.2 million companies.

The benchmark companies are stated by EET Group to be selected after a targeted search followed by a quantitative screening (a manual review of the companies' financial ratios) and a qualitative screening (a manual review of the companies' company descriptions).

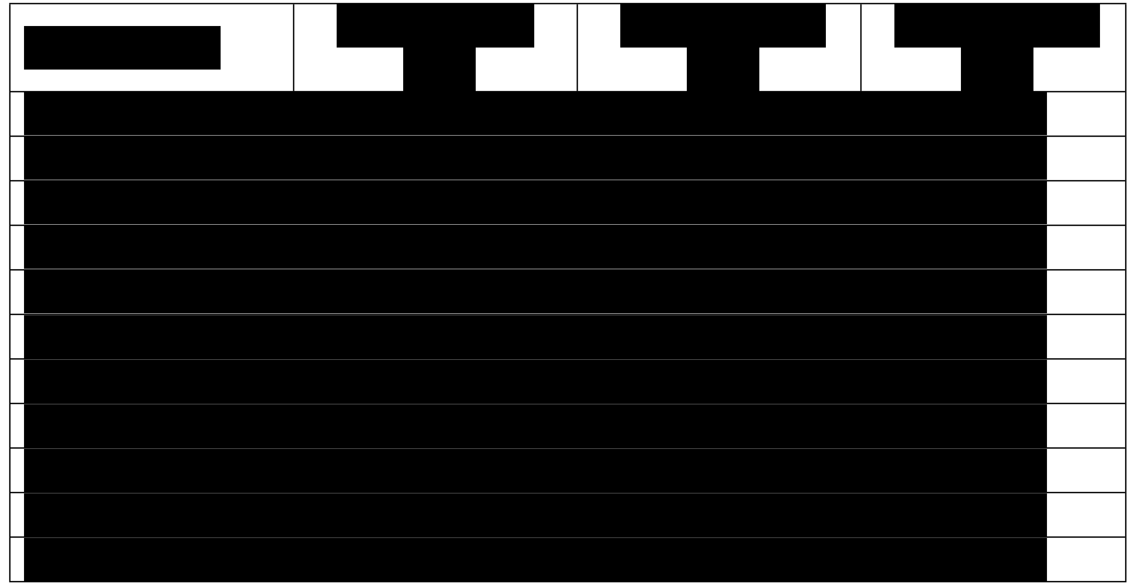
In the quantitative screening, the number of potential benchmark companies was narrowed down from the approximately 3.2 million selected companies to 203 companies using a number of selection criteria. Among the criteria was that the companies could not have intangible assets or an inventory of more than 3.5% of revenue.

In the qualitative screening of the 203 companies accepted after the quantitative screening, the number of companies was narrowed down to 7 companies.

The ranges for the 7 selected companies' gross margins are described in the documentation as follows:

Minimum	Lower quartile	Median	Upper quartile	Max.
2.4 %	8.3 %	11.6 %	15.9 %	28.9 %

The total gross margins of the EET sales companies are stated in the individual transfer pricing documentation and are summarized in the following table:



Expert statement

EET Group has submitted an expert statement from Professor Mogens Steffensen, University of Copenhagen, on the use of statistical intervals to narrow down results from database studies when determining arm's length prices and terms in transfer pricing cases. The statement, which is dated December 18, 2019, states the following, among other things:

> "When testing whether a company's profits "match" the profits in the comparison portfolio, you are actually doing what is called an outlier test. To do this, it is necessary to determine an acceptable probability that a true hypothesis will be wrongly rejected.
> This is called the significance level. The significance level in this case represents the risk of incorrectly assessing a non-outlier to be an outlier. A conventional choice of significance level in statistical measurement is 5%, but 0.5%, 1% and 10% are also used.
>
> The Danish Tax Agency's restriction to the interquartile range corresponds to a significance level of 50% is tantamount with a risk of incorrectly assessing an arm's length profit to be a non-arm's length profit is 50%. This is highly unconventional.
>
> If the interquartile range is to be used, it must be increased by a suitable (in relation to the choice of significance level) factor. Below is an explanation of the size of this factor at a significance level of 1%, 5% and 10% respectively.
>
> If there is uncertainty about the comparability between the comparison portfolio and the tested company, the intervals determined by the significance level (in the absence of comparison defects) can be considered as minimum intervals. By minimum intervals I mean that in order to achieve the same certainty of not drawing erroneous conclusions (same significance level), the intervals should be increased when there is uncertainty about comparability. Thus, if there are comparison defects and it is not possible to identify which observations in the comparison portfolio should be removed, the Danish Tax Agency's restriction to the interquartile range means that the significance level - and thus the risk of erroneous conclusions - exceeds 50%.
>
> Correcting an outlier is not done conventionally in statistical methods but must be done pragmatically. There are natural criteria that speak in favor of correcting to the nearest point in the interval.
>
> The Tax Agency's correction to the median does not meet these natural criteria."

An expert appraisal was carried out in the case by appraiser Søren Feodor Nielsen. The appraisal report, which is dated January 14, 2023, states the following, among other things:

> "Question 1:
> Can the appraiser state whether it is generally an advantage to have more observations in a dataset if the extra observations are not of better quality than the other observations in the dataset?
>
> Answer question 1:
> Generally speaking, more observations mean less uncertainty in the statistical results. In general, more observations are therefore an advantage. However, there are exceptions, where the "quality" of the observations becomes important.
> "Quality" of observations is not a commonly used statistical term. It can therefore mean several things. The important "quality" of observations in relation to the statistical results is that the observations are representative - true - of the phenomenon to be investigated: The gross margin observations included in the data must resemble the full population of gross margins. Quality in this sense is one-or-one. If the observations are representative, then more observations will always be an advantage. If they are not representative, then more observations will be further misleading, so in this case more observations will not be an advantage.
> "Quality" can also refer to the "type" of observation. A gross margin calculated in "dollars and cents" is a higher quality observation than one that is rounded to a whole number of millions. Higher quality observations contain more information than lower quality observations, but as long as they are representative, more observations are always preferable. Extracting results from observations of different types is more difficult but not impossible.
> The importance of observations being representative is a statistical "basic law". It is thus widely recognized and well described in the statistical literature. That more representative observations are better than fewer is also widely recognized and described in the literature.
>
> Question 2:
> In continuation of question 1, please inform the appraiser whether an increase in the number of observations is more significant the smaller the dataset is in the starting point.
>
> Answer question 2:
> It is true that an increase in the number of observations will have a greater impact the smaller the data set.
> For common methods ("estimators"), the uncertainty ("standard error") is inversely proportional to the square root of the number of observations. Halving the uncertainty requires four times as many observations. Thus, 30 extra observations will halve the uncertainty if the starting point is 10 observations, while they will only lower the uncertainty by 12.3% if the starting point is 100 observations.

The dependence of statistical uncertainty on the number of observations is a mathematical fact. It appears in many textbooks, probably most of which contain formulas for standard errors.

Question 3:
Please state whether the fact that this is a sample with a limited number of observations means that it is possible that the true interval (the full population of all comparable observations) may be larger/wider than the interval of the sample, and thus that the extremes of the true interval may be lower or higher than the extremes of the sample.

Answer question 3:
It is certainly conceivable that the range obtained from a sample is smaller than the "true" range in the sense that the lower limit may be too high and the upper limit too low.
All statistical results are subject to uncertainty. Statistics is very much about obtaining the most certain results possible and being able to quantify the uncertainty that is present.
The fact that all statistical results are subject to uncertainty is widely recognized and well described in the literature.

Question 4:
Can the appraiser confirm that when a weighted average of the specific observations for a multi-year period is used when analyzing the range of a dataset (e.g., reducing 21 observations from the years 2010-2012 to 7 observations, each of which is a weighted average of 3 observations from the years 2010-2012), this in itself implies a narrowing compared to a range based on all observations (the 21 observations in the example above)?

Answer question 4:
It is true that a range based on (weighted) averages of observations will be narrower than a range based on individual observations: the value of a (weighted) average is never smaller than the smallest observation included in the calculation and never larger than the largest, unless some of the weights are negative, which would be highly unusual.
This is a simple mathematical fact and is therefore universally accepted.

Question 5:
Please briefly explain the statistical concept of the inter-quartile range (IQR).

Answer question 5:
The interquartile range is the interval from the lower (or first) quartile to the upper (or third) quartile. Informally, the lower quartile is the observation where 25% of all observations are less than this, while the upper quartile is the observation where 75% of all observations are less than this. The actual calculation of quartiles can be done in several more or less mathematically valid ways; see the answer to questions 14-16.
The interquartile range is thus the

interval that contains 50% of the middle observations. It thus excludes 25% of the smallest and 25% of the largest observations. There is general agreement on what the interquartile range is, and it is described in the literature. The actual calculation of it from given data, on the other hand, is probably not widely agreed upon; see the answer to question 14.

Question 6:
Can the appraiser confirm that narrowing a dataset to IQR will imply that approximately 50% of the observations in the dataset are then estimated to fall outside the adjusted range?

Answer question 6:
It is correct that about 50% of the observations will be outside the interquartile range.
Since this follows logically from what the interquartile range is, this is widely recognized.

Question 7:
Please explain whether it is consistent with good statistical methodology to remove observations unless there is a reasonable suspicion that a specific observation is flawed.

Answer question 7:
It would be contrary to good statistical methodology to disregard observations that are representative of the population you are interested in studying.
Flawed observations are not representative. It would be contrary to good statistical methodology to include flawed observations in the calculations. If it is not possible to correct the error, a flawed observation should be excluded.
The importance of representativeness of observations is widely recognized and well described in the statistical literature. How strong a suspicion is needed for a given observation to be omitted is probably not something on which there is general agreement.

Question 8:
The appraiser is asked to consider that the purpose of the comparability analysis is to establish a range (including identifying the extremes of that range). On this basis, the appraiser is asked to state whether in this situation particular care will be taken to remove observations unless there is a reasonable suspicion that a specific observation is flawed.

Answer question 8:
One should always be careful about omitting observations. Calculating quartiles - the endpoints of the quartile interval - is among the statistical methods that provide statistically valid results even if some of the observations are flawed: Since the value of the lower quartile does not depend on the exact values of the (approximately) 25% smallest observations, it is not a problem if (some of) the 25% smallest observations are too small. If they are too large, without being grossly too large, it will make the lower quartile slightly, but not much, too large. A

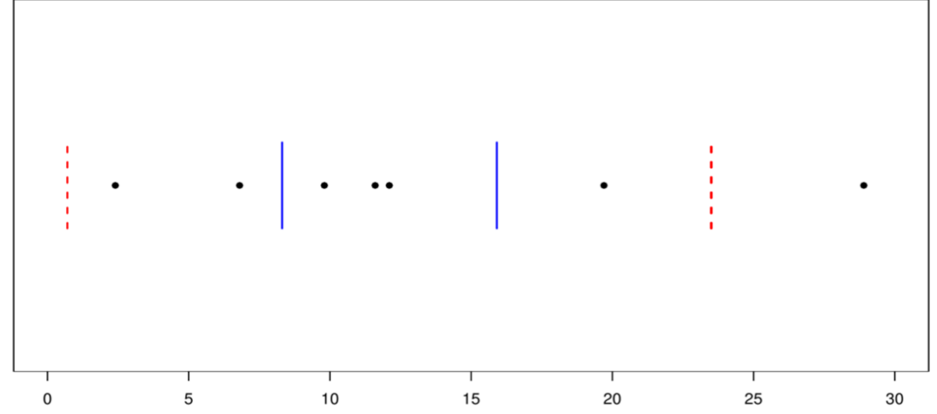
similar consideration applies to the upper quarters, of course. Whether this means that you should be particularly careful about removing an observation that is suspected to be flawed is probably something that statisticians will have different opinions on.

Question 9:
Can the appraiser confirm that if there is a suspicion that there may be outliers in a dataset, the 1.5*IQR rule is a rule of thumb (among several methods) for identifying outliers?

Answer to question 9:
It is hardly uncommon to use 1.5 times IQR as a rule of thumb to identify outliers.
The "1.5 times IQR" rule appears in a number of textbooks. However, there is hardly any consensus on whether it is a good rule or not.

Question 10:
Please briefly explain the 1.5*IQR rule, including whether it is correct that the 1.5*IQR rule describes that if a value is less than 1. quartile minus 1.5 times the IQR (the distance between the 1st and 3rd quartile) or greater than the 3rd quartile plus 1.5 times the IQR, then the value is an outlier compared to the rest of the dataset?

Answer question 10:
IQR - the interquartile range - is the difference between the upper and lower quartiles. The "1.5 times IQR" rule is that an observation smaller than the lower quartile minus 1.5 times IQR might be an outlier, and an observation larger than the upper quartile plus 1.5 times IQR might be an outlier. The rule is illustrated in the figure below: The black dots are the observations (taken from question 16) and the blue lines indicate the two quartiles (here calculated with Excel's QUARTILE.INC). The red dashed lines are placed 1.5 times the IQR below and above the two quartiles. The "1.5 times IQR" rule with quartiles calculated with Excel's QUARTILE.INC means that the largest observation is an outlier.



There will generally be a positive probability that valid observations will fall more than 1.5 times the IQR from the quartiles. For distributions that typically appear in textbooks, we can get probabilities like 0% (joint distribution), 0.7% (normal distribution), 4.5% (chi-squared distribution with 2 degrees of freedom) and 8.2% (t distribution with 2 degrees of freedom) of finding valid observations outside 1.5 times IQR from the quartiles. The more observations in the dataset, the greater the chance of having observations further away than 1.5 times the IQR from the quartiles. It would therefore be wrong to blindly categorize observations as outliers simply because they fall outside 1.5 times the IQR of the quartiles.
That there is usually a positive probability that valid, non-flawed observations fall outside 1.5 times the IQR of the quartiles is a thematic fact and therefore something that is generally agreed upon. However, as mentioned, there is hardly any general agreement on whether the "1.5 times IQR" rule is a good rule or not. That it would be wrong to blindly rely on the rule is my opinion, hardly a universally recognized opinion, but not an uncommon one either.

Question 11:
If it is assumed that there is a risk of comparability defects that it is not possible to identify or specifically adjust for in the preparation of the database survey, please explain whether the interval obtained on the basis of a database survey, as described in sections 1 and 2, should, in accordance with good statistical methodology, be adjusted solely as a result of such risk?

Answer to question 11:
To adjust a range based on a database survey based on data containing "comparability defects for which it is not possible to identify or specifically adjust" in a statistically valid way seems to me to be impossible without additional information. Furthermore, to do so if there is "only" a risk of such comparability defects seems to me to be wrong.
I think it is appropriate to mention here that in the specialized statistical literature there is a wide range of methods for processing data with "comparability defects", but they probably all require an insight into how the specific observations differ from representative observations, i.e., an idea of how the comparability defects apply to the data. For example, there are methods for processing data where large or small observations tend to be missing, where large observations are over-represented in a specified way, or where one part of the data is representative while another part is flawed, if you are willing to assume certain things about the representative observations as well as about the errors. There are also methods that are less sensitive to any errors in the data, but they are typically robust to certain types of errors. An example of such a robust method is the quartile interval. However, if what we are interested in is the entire "data interval", then the quartile interval is not a substitute; it is, as implied by the answer to question 6, too small an interval. One could construct methods to extend the quartile interval, but how that would be done would again require additional assumptions about what representative observations look like.

I hope it is clear from the above that this is my position. I think it will be possible to find statisticians with other opinions. Conversely, I do not believe that my position is rare among statisticians. I am not aware of any literature that specifically addresses adjusting a "range for data" based on data that is at risk of being flawed. As mentioned, there is some literature on so-called robust methods. I doubt that you will find methods for the entire "range of data" because from a theoretical statistical point of view it is a very unmanageable size: Different assumptions about the data will lead to very different results about how the "method" will work or not work.

Question 12:
If the answer to question 11 is yes, please explain whether the adjustment involves a widening or a narrowing of the range and how such an adjustment should be made.

Answer to question 12:
I do not consider the answer to question 11 to be affirmative, so I will not answer this question.

Question 13:
If the answer to question 11 is yes, please explain whether the mere fact that there is a risk of comparability defects - without further assessment of the nature of the potential comparability defects and their effect in relation to relevance and/or correct placement in the interval - can justify a narrowing to IQR.

Answer to question 13:
I do not consider the answer to question 11 to be affirmative, so I will not answer this question.

Question 14:
Please assume that the Danish Tax Agency has used quartiles calculated using the QUARTILE.INC function in Excel to calculate quartiles when narrowing down to IQR. Can the appraiser confirm that there are several methods for calculating quartiles and thus IQR, including that Excel, in addition to QUARTILE.INC, also has the QUARTILE.EXC function, which uses a different method?

Answer to question 14:
It is correct that Excel (since 2010) has two functions - QUARTILE.INC and QUARTILE.EXC - for calculating quartiles. The two functions use different methods (formulas), as can be seen, for example, in the answer to question 16.
That Excel contains two functions for calculating quartiles is a fact, not an opinion. It is doubtful that it is described in the literature, and it makes no sense to consider whether it is "common practice".

Question 15:
Can the assessor confirm that the methodology used by QUARTILE.INC will normally lead to a more narrow or dependent dataset-

IQR at least as narrow as the other methods, and that QUARTILE.EXC will often lead to a wider IQR than QUARTILE.INC?

Answer to question 15:
The precise (i.e., mathematical) definition of quartiles is that for a given data set, there is usually a whole range of values - numbers, not observations - that can rightly be called quartiles. This lack of uniqueness is of course problematic for the practical use of quartiles: in practice, we need a number, not a range. So, we choose a specific value in the interval from a formula. There are at least 9 different formulas for calculating quantiles; the quartiles are two specific quantiles. These formulas all give mathematically valid results, and there is no universal agreement on which formula is the "right" one.
Which formulas are actually implemented in Excel's QUARTILE.INC and QUARTILE.EXC is unfortunately unclear; the documentation is very incomplete. However, there seems to be a high degree of agreement among users about which two formulas Excel implements.
To verify this, for each of 11 different sample sizes (number of observations) between 10 and 20, I have calculated 10,000 randomly generated examples. All calculated examples fit exactly (up to the 14th decimal place) with two specific commonly used formulas for calculating quartiles, the two formulas that are generally agreed that Excel implements.
For all calculated examples, QUARTILE.EXC gives a wider quartile range than QUARTILE.INC. This is in accordance with the formulas: The formula implemented with high confidence in Excel's QUARTILE.EXC will always give a lower (upper) quartile that is no larger (smaller) than the formula implemented with high confidence in Excel's QUARTILE.INC gives.
Excel's formulas are hardly described in the literature and certainly do not belong to what could be described as common practice. However, I would not call my answer an expression of my judgment or opinion, but rather a logical consequence of extensive experimentation.

Question 16:
Can the appraiser confirm that applying QUARTILE.INC and QUARTILE.EXC to the data set of 7 observations below will result in IQRs of 8.3 - 15.9 and 6.8 - 19.7 respectively as shown in the table below?

Observation no.	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Value	2.4	6.8	9.8	11.6	12.1	19.7	28.9
IQR (Quarti-le.INC)	8.3 - 15.9						
IQR (Quarti-le.EXC)	6.8 - 19.7						

Answer to question 16:
I can confirm that applying Excel's QUARTILE.INC to the numbers given in the question will give the quartile range 8.3-15.9, while QUARTILE.EXC gives 6.8-19.7.

> This answer is based on concrete calculations that anyone with access to Excel can verify. There will therefore be universal agreement on the answer."

For the purpose of this case, the Danish Tax Agency has investigated the practice of companies and advisors regarding the use of the interquartile range and the full range, respectively. The investigation is contained in a report from the Danish Tax Agency from January 2024, which states the following in the conclusion:

> "The conclusion of the study is that interquartile ranges are used in 95 percent of the analyzed transactions and full range in 5 percent of the transactions.
>
> It can also be concluded that in cases where database research is used, TNMM (97 percent) is by far the most used method to price the controlled transactions.
>
> In conclusion, the study shows that the majority (61 percent) of the database studies surveyed were conducted with between 5 and 15 companies."

Explanations

Jan Holmetoft Iversen and expert appraiser Søren Feodor Nielsen have made a statement.

<u>Jan Holmetoft Iversen</u> has explained, among other things, that he has a degree in accounting and a master's degree in business administration. He was employed by EET with effect from June 1, 2000.

EET was founded in 1986 by Swedish entrepreneur Martin Baaz Lindquist, who had the idea of selling memory cards etc. for computers as a competitor to the established brands. In 1988, the Danish company was founded by Per and Lasse Frost, who were acquaintances of Martin Baaz Lindquist, and in 1990, the Norwegian company was founded by Tom and Tore Vedvik, who were acquaintances of both Per and Lasse Frost and Martin Baaz Lindquist. The three companies all traded in the same goods, i.e., IT components. In 1991, a Finnish company was founded, of which each of the other three Nordic EET companies owned 1/3.

From the founding and until 1997, there was no actual group, as all the companies were owned by different owners and did not have common functions etc. In 1997, an agreement was reached between the owners of the EET companies and a capital fund to sell half of the companies, and a group structure was established in which the headquarters ended up being located in Denmark. Per Frost became CEO of the group.

When the group was established, it was decided to hire John Thomas as CFO. John Thomas was hired to acquire companies and expand EET into Europe. In 2000, Per Frost resigned and John Thomas became the new CEO of the group. John Thomas hired the witness as the group's new CFO.

The group had planned an IPO in 1999, but this was abandoned when the IT bubble burst. The termination of the partnership with had a major negative impact on the EET Group's financial results, and the Group's earnings before depreciation (EBITDA) fell from DKK 60 million in the 1999/2000 financial year to DKK 30 million in 2000/2001 and DKK 3 million in 2001/2002

As a result, it was decided to centralize as many back-office functions as possible in Denmark. The local warehouses in Sweden and Finland were closed, leases were reduced and local administration (bookkeeping etc.) was handled by the Danish company. Sales to customers were not centralized, but continued to be handled by the sales companies, as the products are best sold locally. It is EET Group that buys the goods and is responsible for the warehouse. However, as the demand is local, the sales companies bid on what should be in the warehouse.

The EET website is the same in all countries. The local languages are used. However, there may be differences in the products offered on the individual websites. Back then, only about 1/3 of the contribution margin came from sales via the website, while the rest came from sales where salespeople were in contact with the customer over the phone. Today, % of the contribution margin comes from sales via the website. EET would like more customers to buy through the website, as there is less work for the local sales companies involved, which increases sales efficiency. The goods cost the same for the customer, regardless of whether they have received advice or not in connection with the purchase.

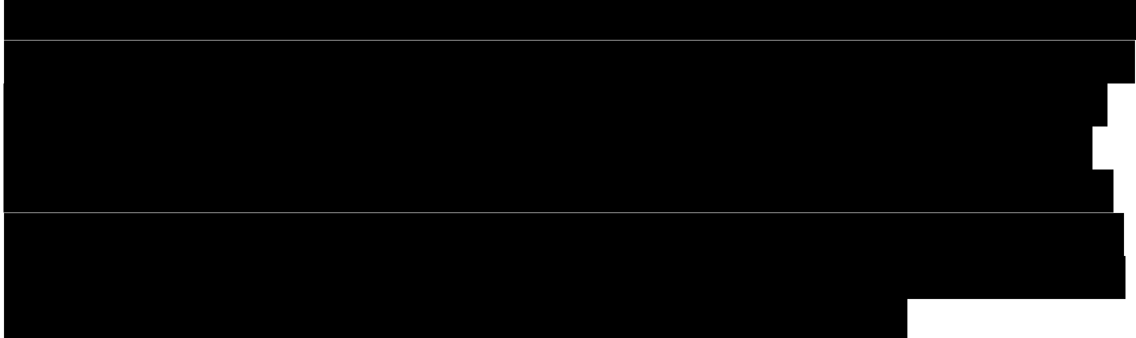
The biggest risk for EET Group is if what is in the warehouse cannot be sold. This risk is therefore included in the price that the sales companies pay to EET Group. The sales companies also pay for the various back-office services based on a cost-plus method. EET Group has no development department and therefore no risks associated with this.

Sales companies have a high degree of autonomy and can decide most things themselves. They are forced to use [redacted] but this is basically the only thing they have been dictated by EET Group. Since the sales companies generally do not have their own inventory, they have limited risk.

When EET Group sells to the sales companies, various surcharges are added to the price to cover, among other things, freight costs, any duty or tax, insurance, and packaging, as well as a percentage surcharge for physical handling of the individual item. In addition, the goods are subject to surcharges that ensure EET Group makes a profit on the sale. He is in constant dialog with the sales companies about EET Group's prices because he, from their point of view, makes the products more expensive. If he sets the price too high, the sales companies will instead buy the goods locally from another source. EET Group cannot show that the sales companies have been able to buy all goods at a lower price from external suppliers.

On branded products, EET Group's gross margins will typically be lower than those of the sales companies, as it is easier to buy than to sell. On the other hand, EET Group will typically have higher gross margins than the sales companies on their own branded goods, as EET Group must receive the producer margin on these goods. However, the sales companies also have an attractive gross margin on these goods, as it is necessary for it to be attractive for them to sell the goods. EET Group does not determine the prices at which the sales companies sell the goods to customers. This is decided by the individual sales companies themselves and therefore the gross margins vary from country to country.

One of the reasons for the differences in gross margins is that the types of products sold by the individual sales companies vary. For example, [redacted] only sells [redacted] which has a high gross margin, while [redacted] , [redacted] and [redacted] sell the entire product portfolio and thus also products with a lower gross margin. The difference in gross margins may also be due to differences in the skill level of each sales company's salespeople.



Net margins vary from sales company to sales company. This is due to differences in the companies' fixed costs, including salaries etc. which vary from country to country. In addition, sales volume has a certain impact on net margins, as a higher volume results in a higher contribution margin. In his opinion, EET Group's net margin fits well with the function that EET Group has performed and been paid for.

EET Group's net margin is, among other things, affected by the operations that the company has in addition to sales to the sales companies, including, for example, expenses for lawyers and accountants. As a growth company, EET Group has also had various costs for the acquisition and sale of companies that have had an impact on the company's net margin. For example, in 2012, EET Group acquired the French-based Europarts Group and was responsible for the related costs. Europarts had essentially the same product portfolio as EET and had similar gross margins. However, Europarts made "no money" due to their cost base, especially costs for warehousing, IT function, bookkeeping, etc. in the individual countries.

The EET Group has a common way of recording finances for all sales companies. There are 12 monthly accounts per year, and it is these internal accounts that the group is guided by. The local financial statements are based on the local accounts, which may differ from the internal accounts.
This is because there are different ways of presenting the accounts in each country. However, there have never been significant differences in how the gross margins are calculated in the local accounts and the internal accounts. The company's transfer pricing documentation is based on the internal accounting.

Having a warehouse is a necessity when selling hardware. That's why all the companies that EET Group has acquired have also had a warehouse. In the EET Group, the warehouse was also centralized at EET Group back in 2010-2012. However, some of the sales companies had a smaller local warehouse, such as the Norwegian company, which had a large local business selling [redacted] , which was purchased externally. In Spain, where [redacted] is primarily sold, there was a local warehouse because it is not possible to get goods from Denmark to customers in Madrid no later than the day after their order,

unless the goods are shipped by air. This decentralized warehouse was thus necessary to maintain a good level of service for local customers.

No segmentation has been made in EET Group's transfer pricing documentation, as it is not practical to prepare separate, segmented accounts for the purely external transactions and the internal transactions due to the very large number of transactions. He looked at a product in Spain that the company had some sales of, and which was purchased both internally and externally. It took him about half an hour to review this single item. He might be able to review subsequent items in 20 minutes per item, but it would still require several months of full-time work to review just the approximately 1,400 items that the Spanish sales company purchased from both EET Group and external suppliers in 2012. Furthermore, it would never be a complete segmentation, but at best an educated guess.

The fact that the Norwegian sales company has had a lower gross margin on goods purchased externally than on goods purchased from the EET Group does not mean that the sales company has not acted at arm's length with the EET Group. The goods purchased externally by the Norwegian sales company are in particular expensive █████, where the gross margin is lower than on, for example, cheaper █████. █████. the sales company has not purchased locally, but from EET Group, and on these products the Norwegian sales company has had the same gross margin as the other sales companies. Thus, the gross margin has nothing to do with whether a product is purchased from EET Group or from an external supplier, but rather depends on the product category.

The work of creating EET Group's transfer pricing documentation is handled by external consultants. Originally Deloitte was responsible for the work, and later it was KPMG. The task for the consultants has been to create documentation that meets the requirements of the legislation. It was not part of the assignment that EET Group should get off cheaper in the Danish Tax Agency. If EET Group had done it the way the tax authorities wanted it done, they would actually have paid less tax than they did.

He cannot explain why the transfer pricing documentation for 2010-2012 shows the lower quartile, median and upper quartile of the benchmark companies' gross margins. He believes that it looked the same way in the documentation for 2007-2009. The documentation is broken down into own brands and generic products to show that there is a difference in the margins. He cannot remember if when they prepared the documentation for the
█████ discussed that the gross margin for the company's own brands was outside the full range. Overall, the gross margin was in any case within the full range.

He believes that the description of the risks for the ██████ sales company in the transfer pricing documentation is correct. It is also correct when the transfer pricing documentation states that the resale price method and the cost-plus method could not be used to test whether arm's length trading has taken place.

He believes that the fact that the benchmark analysis compares companies with inventory for the years 2010 and 2011 is because it is difficult to find comparable companies without inventory. However, as he has not done the data research himself, this is only a guess. He does not believe that he was involved in deciding whether it was EET Group or the sales companies that should be tested. However, it is his opinion that it is easier to test the sales companies than EET Group.

EET Group's prices are set based on a cost-plus method, where EET Group is paid for the risk, it assumes. EET Group does not set prices based on what the local sales companies can sell the product for. The sales companies set their own prices. All salespeople are paid based on gross revenue, not turnover.

He does not think it makes sense to make net profit statements at product level, as the tax authorities have done. Such statements will not show a true picture, as they do not give a real picture of where the earnings lie. It would also be wrong to set prices taking into account the net profits of the sales companies. He therefore does not see why this would support sales companies that do poorly and punish those that do well. There are also minority shareholders in some of the companies, and they are naturally interested in increasing the value of their company. It is therefore important that the group is run on commercial terms.

The EET Group's internal agreements were first formalized in 2014. This was at the request of the group's transfer pricing advisor. Until then, the company had simply acted in the same way as before it became a group. It is correct that the distribution agreement with the Danish sales company states that the sales company has a lower risk than EET Group. He does not agree that EET Group assumes the role of "principal" in the set-up that has been made.

Søren Feodor Nielsen has confirmed his answer to question 11 of expert appraisal and has further explained that if data is valid, observations outside the interquartile range are just as valid as observations within this range. Furthermore, the interquartile range will not, as a starting point, represent the entire range.

The interquartile range is a very common method that indicates the middle 50% of observations. It tells you something about what the population looks like and, like the median, gives a picture of what is normal. There would normally

not be anyone, who would be interested in finding the highest and lowest observation because these observations are statistically the most unstable. However, if what you are interested in is the entire data set, the 50% middle observations that you get with the interquartile range is not the right answer.

The advantage of the interquartile range is that it is not sensitive to observations that deviate greatly from the other observations in the data set. A common way to test for such deviations is to take the mean minus 2-3 times the standard deviation. However, he believes that multiplying the interquartile range by 1.5 would be a better solution, although he is not a fan of that solution either.

Using an interval where you multiply the interquartile range by 1.5, within the normal range there is a 0.7% probability of a valid observation falling outside the interval. This means that if you have 1,000 valid observations, you should expect 7 observations to fall outside the interval. If a valid observation is measured against only the interquartile range, there is a 50% probability that the observation will fall outside the range. Thus, it is just as common to fall outside the interquartile range as within the range because the interquartile range alone contains 50% of the observations.

In his opinion, using an interval where you multiply the interquartile range by 1.5 would remove extreme deviations. Using the interquartile range alone will remove more observations than the interquartile range multiplied by 1.5. Quartiles are popular because they are easy to understand and are more robust than the full interval. The method of multiplying the interquartile range by 1.5 is a way to get around using the quartiles, as the method is still robust but includes more than the interquartile range. He would not use the interquartile range himself to remove uncertainties in a dataset.

It would generally make sense to avoid collecting data that is not valid. However, from a statistical point of view, it would be just as important to look at the data that has been collected. It is important that the data is valid, and he therefore finds it difficult to agree that more data would be better if the very premise of the question is that there may be errors in the data.

There is generally a big difference in the credibility of the data used in statistics. Statistics will normally be based on valid data, i.e., data that is representative of the phenomenon you want to study. As a statistician, it is always preferable that data is valid, but it is not always possible to get valid data. Sensitive questions, such as questions about sexual habits or income, can be difficult to get valid answers to. Furthermore, there is

no doubt that a theoretical statistician will believe that only randomized trials are suitable for obtaining valid data. Such randomized trials are not possible here.

He does not believe that the significance level has any relevance to this case.

The legal basis

The arm's length principle

The rules on the arm's length principle can be found in section 2, subsection 1 of the Danish Tax Assessment Act, cf. Executive Order no. 806 of August 8, 2019, which reads as follows:

> "**Section 2.** Taxpayers,
> 1) over which natural or legal persons exercise a controlling influence,
> 2) exercising a controlling influence over legal entities,
> 3) that is affiliated with a legal entity,
> 4) who have a permanent establishment located abroad,
> 5) is a foreign natural or legal person with a permanent establishment in Denmark, or
> 6) who is a foreign natural or legal person with a hydrocarbon-related business covered by section 21, subsection 1 or 4 of the Hydrocarbon Tax Act shall, when calculating the taxable or distributable income, use the prices and terms of commercial or economic transactions with the above-mentioned parties in points 1-6 (controlled transactions) in accordance with what could have been achieved if the transactions had been concluded between independent parties.
> ..."

Section 2, subsection 1 of the Danish Taxation Act was amended by Act no. 432 of June 26, 1998, on legislative confirmation of the arm's length principle and protection against thin capitalization. From the general comments to the bill, cf. Danish Parliamentary Gazette 1997-98 (2nd session), Appendix A, pages 2454-2455, it appears, inter alia:

> *"Introduction.*
> The purpose of the bill is to legislate that, when calculating taxable income, related parties must use prices and terms for their transactions that correspond to the prices and terms that independent parties would set for similar transactions (the arm's length principle).
> ...
>
> *Legislation of the arm's length principle*
> The general principles of tax law - contained in sections 4-6 of the Danish State Tax Act - state that every taxable person should only be taxed on its own income but should be taxed on all its taxable income. From these principles it has so far been deduced that if transactions are made between two taxpayers that are not at arm's length, it will be possible for the tax authorities to correct the taxable income when calculating the taxable income, so that the income will correspond to what could

have been achieved if the transactions had taken place on arm's length terms. These principles correspond to the basic OECD principles for transfer pricing, i.e., cross-border trade between related parties.
...

It is an internationally recognized principle that interested parties must act on arm's length terms. The OECD has issued guidelines on the principles and practices that can be internationally recognized in the assessment of transfer pricing cases. These guidelines are based on the arm's length principle. All OECD countries - including Denmark - have endorsed these guidelines. The new Danish rules introduced by Act no. 131 of February 25, 1998, amending the Danish Tax Control Act and the Tax Administration Act are thus also in accordance with the OECD guidelines."

Content requirements for transfer pricing documentation
The current section 3 B, subsection 5 of the Danish Tax Control Act reads as follows:

"**Section 3 B..**.
Subsection 5. Subject to subsection 6, the taxpayer shall prepare and retain written documentation of how prices and terms have been determined for the controlled transactions. The written documentation must be submitted to the customs and tax administration upon request and must be of such a nature that it can form the basis for an assessment of whether prices and terms have been determined in accordance with what could have been achieved if the transactions had been concluded between independent parties.
Written documentation in the form of database investigations must only be prepared if requested by the customs and tax administration and with a deadline of at least 60 days. Written documentation shall not be prepared for controlled transactions that are insignificant in scope and frequency. The Customs and Tax Administration shall lay down rules for the content of the written documentation. The rules laid down must be approved by the Tax Council."

Section 3 B, subsection 5 (then subsection 4), was introduced by Act no. 131 of February 25, 1998, amending the Danish Tax Control Act and the Tax Administration Act. From the general comments to the bill, cf. the Danish Parliamentary Gazette 1997-98 (1st session), Appendix A, pages 1896-1897 and 1901-1903, it appears, inter alia:

"Introduction.
The purpose of the bill is to increase the tax authorities' ability to ensure correct pricing and thus correct calculation of taxable income in cross-border intra-group transactions (transfer pricing).

An extended tax return obligation is proposed as well as an obligation to prepare and keep written documentation of prices and terms for intra-group transactions.

The bill means that taxpayers who are associated with companies, persons, etc. abroad must state in the tax return

information on the nature and extent of the commercial or economic transactions with them (controlled transactions). This will only be summary information. On the recommendation of the Tax Council, special information fields will be prepared for the tax returns, where this information must be stated.

In addition, for controlled transactions, documentation must be prepared on how prices and terms have been determined. The written documentation must be of such a nature that it can form the basis for an assessment of whether prices and terms have been set in accordance with what could have been achieved if the transactions had been concluded between independent parties. As a minimum, the company must account for how prices and terms for controlled transactions are actually set. The rules generally leave it up to the taxpayer to assess what further documentation is necessary. This assessment should take into account that the tax authorities will apply the principles of the OECD (Organization for Economic Co-operation and Development) transfer pricing guidelines in the assessment.
The tax authority may request additional documentation or information if the documentation prepared by the taxpayer is not deemed to be a sufficient basis for an assessment of the controlled transactions.
...

Administrative consequences
...

The taxpayers covered by the proposed rules must in future prepare written documentation on how prices and terms are determined for controlled transactions. This material must be kept by the taxpayer and must be submitted to the tax authorities at their request.
...

OECD guidelines
...

Chapter I - Arm's length principle:
...

When applying the arm's length principle, a comparison must be made between the terms between interested parties and non-interested parties. This presupposes that a basis of comparison exists in some accessible form, i.e., that the basis of comparison is identical or that any differences can be corrected for. The comparability test to be performed is described in detail in the guidelines. The comparability test includes the following elements: Comparison of the goods and services exchanged, functional analysis, comparison of the contractual terms, comparison of the economic circumstances in terms of market conditions etc. and of the parties' business strategies. In transactions between two independent parties, the financial compensation will normally reflect the functions that each party undertakes, including which

assets are deployed and the risks assumed. The functional analysis assesses how tasks and risks are allocated between the parties, i.e., it examines which of the parties performs the different functions such as design, production, assembly, research and development, service and warranty, purchasing, distribution, advertising and marketing, transportation, financing, and management. The comparability test must be carried out regardless of the method used for pricing.
...

Chapters II and III - Traditional transaction-based methods and other methods (margin-based methods)
...

Chapter II describes the so-called 'traditional transaction-based methods'. These methods are the free-market price method (CUP method), the resale price method and the cost-plus profit method.

The free-market price method compares the price of goods and services with the price of similar goods or services transferred between independent parties. In this comparison, it is necessary to primarily examine whether there are products that are sufficiently comparable. If this is not the case, adjustments must be made as far as possible to eliminate the existing differences. Furthermore, a number of other factors that may affect prices must be taken into account. For example, it is necessary to take into account whether the markets where the goods are sold are economically comparable, whether the time of sale is the same, whether the goods are sold at the same point in the chain from producer to consumer, etc. If factors such as those mentioned above have a significant impact on price, adjustments must again be made to eliminate these differences.

The free-market price method is the most direct method and should be used in all cases where sufficiently comparable products are available. However, it is not always possible to find sufficiently comparable products, so it may be necessary to use one of the following methods.

The resale price method begins by determining the price at which a product purchased from a related company is resold to an unrelated company. This resale price is then reduced by a reasonable gross margin. After deducting this, the residual amount can be considered an arm's length price for the original transfer of the product. Using this method usually requires fewer adjustments for differences in the products than the previous method. However, adjustments are required for functions performed prior to or in connection with resale. This may be further processing of the product, the application of a trademark, the assumption of a guarantee, etc. The resale price is most easily found when the product is not significantly changed before or in connection with resale. Furthermore, adjustments must be made if the reseller has a monopoly on the resale of the product.

The cost-plus profit method is based on the costs incurred by an entity in respect of assets or services transferred or provided to a related entity. This amount is grossed up by a reasonable gross profit (e.g., may be equal to the gross profit on sales to unrelated businesses). ...
...

The above methods, which have been generally accepted for many years, are preferable when determining whether the conditions of commercial and financial relations between associated enterprises comply with the arm's length principle.

However, the complexity of the business world may mean that traditional methods cannot be used on their own or, in exceptional cases, cannot be used at all. For example, there may be a highly integrated group that manufactures one or more unique products. In these cases, it may be very difficult or impossible to obtain external material that can be used as a basis for a comparability analysis.

For these situations, other methods that may be used to approximate arm's length conditions are described in Chapter III. These methods are referred to as "transactional mark-up methods", i.e., methods that examine the profits realized from specific transactions between related enterprises. According to the OECD guidelines, the only profit methods that comply with the arm's length principle are the methods consistent with the "profit split method" and the "transactional net margin method". The profit split method first identifies the total net margin to be allocated between associated enterprises that arises from their internal transactions. The margin is then allocated between the associated enterprises based on an analysis of the functions contributed by each entity. In determining the value of the functions performed, comparisons are made as far as possible with similar functions performed by independent companies.

The transactional net margin method examines the net margin that a company realizes from an internal transaction. Ideally, the net margin of the entity should be determined by comparing it with the net margin realized by the entity in similar transactions with unrelated entities. Where this is not possible, the net margin of an independent enterprise in a comparable transaction may be used as a guide. It is noted that reliable comparability analysis is often difficult to perform under this method.

It is concluded in the guidelines that these two methods, the mark-up method, and the transaction-based net margin method, should only be used as a "last resort". So far, only a few countries have experience with the transactional profit methods, which is why it is the intention that the use of the different methods will be monitored by the OECD in the coming years.

> The methods listed in the guidelines are not exhaustive. According to the guidelines, other methods may also be applicable, but only if they are in accordance with the arm's length principle."

In the bill's comments to the proposed section 3 B, subsection (4) (now subsection (5)), cf. Danish Official Gazette 1997-98 (1st session), Appendix A, page 1907, it is stated, inter alia:

> "The provision does not specify exactly what documentation must be prepared by the individual taxpayer. This is not possible due to the large differences in the structure and activities of companies. Furthermore, taxpayers are generally in the best position to assess what documentation best demonstrates that prices and terms are within arm's length terms.
>
> As a minimum, taxpayers must explain how prices and terms for controlled transactions are actually determined. For example, if the price and terms are based on similar prices and terms for sales to independent parties, this must be stated and any deviations from this must be justified. If the taxpayer does not have corresponding sales to independent parties and there are no comparable goods, an alternative solution may be to look at the group's net profit. This net profit is distributed within the group according to the functions performed. In other words, the taxpayer's share of the group's profits on the product in question must correspond to the functions the taxpayer has performed regarding the product in question.
>
> The above examples correspond to the OECD guidelines' free market price method and the profit split method. The calculation of the transfer prices will probably as of already today not deviate significantly from the guidelines already today. In the future, the calculation will simply be written down. It is generally not necessary for companies to prepare a major analysis or buy access to databases with comparable data. Companies should be able to prepare sufficient documentation themselves, as documentation is not required to the same extent as that required by the tax authorities in the United States, for example. In the US, they have been working with transfer pricing rules for a number of years, so both companies and tax authorities are much better equipped to apply the rules. If documentation has been prepared for a group's transfer pricing for use by the tax authorities in the US or another country, this documentation - if it covers the controlled transactions - can be used in Denmark. However, it may be necessary to provide additional information."

In the bill which led to amendments to section 3 B by Act no. 408 of June 1, 2005, the following, among other things, is stated in the general remarks, see proceedings of the Danish Parliament 2004-05 (2nd session), Appendix A, pages 4907-4913):

> "*1. Purpose of the bill*
>
> ...

Thirdly, the bill aims to improve the quality of the documentation to be prepared. This is proposed to be ensured through the establishment of new rules that provide a firmer framework for the content of the written documentation. However, based on a proportionality consideration, it is proposed that database investigations must only be prepared if the tax authorities (customs and tax administration) expressly request this. Furthermore, it is stipulated that no documentation must be prepared for controlled transactions that are insignificant in scope and frequency.

Fourthly, the purpose is to ensure that there can be no speculation in waiting to prepare the documentation until a possible appeal. By waiting, the costs of the documentation can, according to current rules, be covered under the rules on reimbursement of costs for expert statements and other evidence.
...

2. Applicable rules
...

The obligation of documentation means that the taxpayer must prepare and retain written documentation of how prices and terms have been determined. The written documentation must be of such a nature that it can form the basis for an assessment of whether prices and terms have been determined in accordance with what could have been achieved if the transactions had been concluded between independent parties. The documentation must only be submitted to the tax authorities (customs and tax administration) upon request. The documentation must be available in time so that it can be provided if the tax authorities (customs and tax administration) request it immediately after submission of the tax return. The rules in section 6 of the Danish Tax Control Act on the obligation to submit material that may be of importance to the tax assessment apply to transfer pricing documentation. In principle, the taxpayer is thus obliged to submit or hand over the documentation when the tax authorities (customs and tax administration) request the documentation.
...

There are no precise requirements for what the documentation must contain, and there are no formal requirements for the documentation. The reason for this is that transfer pricing is not an exact science and that there are so many differences in the structure and activities of companies that it is not considered possible. The rules basically leave it to the taxpayer to assess what documentation is necessary. However, as a minimum, the taxpayer must account for how prices and terms for the controlled transactions are actually determined. Furthermore, the taxpayer's assessment of what additional documentation is necessary must take into account that the tax authorities will apply the principles in the OECD's guidelines on transfer pricing, cf. the OECD publication - Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

The explanatory notes to section 3 B of the Danish Tax Control Act contain an explanation of the 5 pricing methods in the OECD's guidelines on transfer pricing, which are generally used when determining prices and assessing whether arm's length transactions have taken place. These 5 methods generally require a comparison with transactions between independent companies. The notes explain the hierarchy of the 5 methods and mention that companies may use one of the so-called profit-based methods if necessary.

It appears from these comments that the taxpayer - in accordance with the OECD guidelines on transfer pricing - decides which method is most applicable. Thus, it can be concluded that these legislative notes generally assume that a comparison of the controlled transactions with transactions between independent parties is normally made. This is also in line with the fact that, according to section 2 of the Danish Tax Assessment Act, companies must self-report in accordance with the arm's length principle. If the controlled transactions are not determined with regard to a comparison with transactions between independent parties, it is difficult for companies to be certain that the controlled transactions are determined on arm's length terms.

Against this background, it must normally be expected that the taxpayer's documentation is based on a comparison with independent transactions in accordance with the OECD guidelines on transfer pricing. The comparable data can, for example, be the taxpayer's own transactions with unrelated parties.

It should be noted that the expectation of using a comparison with independent transactions should also be seen in the context of the application of transfer pricing abroad. Danish (subsidiary or parent) companies will thus in any case often - and to an increasing extent - have to base their intercompany settlement on a comparison with independent transactions to comply with foreign documentation rules or in connection with a foreign transfer pricing audit.

The OECD transfer pricing guidelines contain a description of the comparability test to be performed. In particular, the comparability test includes the following elements: comparison of the goods and services exchanged, functional analysis, comparison of the contract terms, comparison of the economic circumstances in terms of market conditions etc. and of the parties' business strategies.
It must be expected that the description of the general part of the documentation contains the necessary information for the tax authorities (customs and tax administration) to make an assessment of whether the taxpayer's-controlled transactions are comparable with the independent transactions chosen as a basis for comparison. It is thus assumed, among other things, that the documentation contains a list and comprehensive description of all the controlled transactions as well as a comprehensive functional analysis and an account of other factors of importance for comparability, cf. the relevant guidelines in the OECD guidelines on transfer pricing. However, it should be noted that expectations in relation to the requirements for the documentation prepared will always depend on the specific circumstances, including the scope and complexity of the transactions.

Under the current rules, it may be necessary for the taxpayer to prepare

material solely for tax purposes and it may be necessary to obtain information from foreign related companies.

...

3. Background and content of the bill

...

3.3 Raising the standard of documentation

It is assessed that there is a need to clarify the current documentation obligation to raise the standard of documentation in practice so that the tax authorities (customs and tax administration) can assess whether prices and terms are arm's length, cf. e.g., the above study. The requirement for documentation of the necessary quality is not only for the tax authorities (customs and tax administration). A high standard of documentation also has advantages for businesses.

From a proportionality perspective, it has also been assessed that it may be relevant to introduce a division of the documentation requirement so that the more resource-intensive part of the documentation must only be prepared if the tax authorities (customs and tax administration) explicitly request it. This involves conducting database searches. Furthermore, it is proposed that controlled transactions that are insignificant in scope and frequency should not be documented.

To ensure that the documentation prepared has the necessary quality, it is proposed that, through the establishment of new rules, a firmer framework is established for what the written documentation must contain. This means that the basis for the rules is the current rules, cf. the description in section 2, and thus that the new rules are not intended to be relaxed in relation to what applies today.

The overall framework for rulemaking will continue to be the OECD guidelines on transfer pricing. The rules should be set so that the taxpayer does not incur unreasonable administrative burdens - the tax authorities (customs and tax administration) should only be able to require the information necessary to assess whether prices and terms are at arm's length - however, it may be included that the taxpayer may have to prepare material where the preparation is solely for tax purposes. When setting the rules, it should also be taken into account that companies are different and thus that there is a need for flexibility.

The legal requirement is that the taxpayer's documentation must be of such a nature that it can form the basis for an assessment of whether prices and terms are set in accordance with what could have been achieved if the transactions were concluded between independent parties. This requirement

must be reflected in the establishment of the new rules. It must therefore be included as a mandatory requirement in the new rules that the documentation as a minimum contains information of such a nature that the tax authorities (customs and tax administration) can make such an assessment. This means that the rules must necessarily include requirements for a description of the company, a description of the controlled transactions, a functional and risk analysis, and a description of financial conditions. In other words - it cannot be included in the rules that the documentation, for example, does not need to contain a description of the company or the controlled transactions. Flexibility can only be built in in terms of how extensive the descriptions should be, what information should be included, etc.

The application of the arm's length principle is based on a comparison with transactions between independent parties when determining transfer prices. It is thus part of the documentation obligation that comparable independent transactions are searched for and that this process of finding comparable data is documented."

Announcement no. 42 of January 24, 2006, on documentation of the pricing of controlled transactions (the TP Executive Order), issued pursuant to Section 3 B, subsection 5, fifth sentence of the Danish Tax Control Act contains the following provisions, among others:

"**Section 2.** Documentation must form the basis for an assessment of whether prices and terms have been set in accordance with what could have been achieved if the transactions had been concluded between independent parties and contain the descriptions and analyses described in subsections 4-8. It is not a condition that the documentation follows the structure in subsections 4-8. *Subsection 2.* The scope of the descriptions, analyses, etc. mentioned in sections 4-8 depends on the scope and complexity of the company and the controlled transactions.
Subsection 3. The documentation may be prepared in Danish, Norwegian, Swedish, or English.
Subsection 4. The documentation must be forwarded to the Customs and Tax Administration within 60 days upon request.
...

Section 4. The documentation must contain a description that gives the customs and tax administration an overview of the group and the business activities.
Subsection 2. The description must contain:
1) A description of the group's legal structure, including the geographical location of the group entities.
2) A description of the organizational structure, including an indication of the primary business activity of the taxpayer and of the related parties with whom the taxpayer has had controlled transactions.

3) A statement showing the last 3 years' revenue and operating profit for the taxpayer and for related parties with whom the taxpayer has had controlled transactions.
4) A brief historical description of the group and the company, a description of any restructuring and changes in significant functions and risks, and an explanation of any losses.
5) A brief description of the industry conditions for the group, including an indication of the most important competitive parameters.

Section 5. The documentation must contain a description of the controlled transactions.
Subsection 2. Several transactions can be described as one (aggregated). It must be described which transactions are aggregated.
Subsection 3. The controlled transactions shall be identified in terms of how much has been transferred and between which connected parties.
Subsection 4. The controlled transactions must also be described in relation to:
1) Features of products (goods, services, assets, intangible assets, etc.).
2) A functional analysis (functions, assets, and risks.)
3) Contract terms.
4) Economic circumstances.
5) Business strategies.
Subsection 5. Any cost sharing agreements shall be described.
Subsection 6. Any other circumstances that are specifically assessed to be of importance for an arm's length assessment must be described.

Section 6. The documentation must contain a comparability analysis which, together with the descriptions in sections 4-5, can form the basis for an assessment of whether the principles for pricing the controlled transactions are in accordance with the arm's length principle, see subsections 2-4.
Subsection. 2. The analysis must contain a description of the pricing of the controlled transactions. The analysis must also include an explanation of why the pricing is assessed to be in accordance with the arm's length principle, including an account of comparable independent transactions used and justification for the choice of method.
Subsection 3. In applying subsection 2, the taxpayer's own transactions with independent parties and transactions between independent parties, including other related parties' transactions with independent parties, shall be used. Furthermore, the possible comparable independent transactions that the company has not selected must be stated, as well as the reasons for why they have not been selected.
Subsection 4. The taxpayer is not obliged to prepare database searches, cf. section 10. If database studies are nevertheless prepared, they must be attached to the documentation.

Section 7. The documentation must contain a general account of the implementation of the principles for pricing.
Subsection. 2. The report must also specify to what extent the taxpayer or related parties have made subsequent adjustments of prices and terms for the controlled transactions in Denmark

or abroad. The specification shall include information on the extent to which these subsequent adjustments comply with the arm's length principle.

Section 8. The documentation must contain a list of any written agreements concerning the controlled transactions.
Subsection 2. The documentation must also include copies of any written agreements that the taxpayer or related parties have entered into with authorities in other countries regarding controlled transactions. This applies to both agreements with retrospective and prospective effect. Subsections 1 and 2 do not apply to written agreements to which the Danish tax authorities are party.

Section 9. During a tax inspection, the Customs and Tax Administration may request additional information and material, including the preparation of additional material. Information and material that may be considered relevant to an arm's length assessment may be requested, including information and material for elaboration and control of the descriptions, analyses etc. mentioned in sections 4-8 and section 10. Section 2(3) applies correspondingly.

Section 10. The Customs and Tax Administration may request the taxpayer to prepare a database examination for one or more controlled transactions**.** A request for a database examination can only be made during a tax inspection.
Subsection 2. A database examination means a search for a basis of comparison that can be used for pricing and assessment of whether the pricing of controlled transactions is on arm's length terms. The search is carried out in publicly available databases, including possibly against payment.
Subsection 3. The database examination must contain:
1) Identification of transaction(s) being tested, and pricing methodology used.
2) Description of the selection process, including justification of quantitative and qualitative selection criteria.
3) Explanation for using adjustments and interval.
4) Documentation material from database and other data used.
5) Subsection 4. The Customs and Tax Administration must give the taxpayer a deadline of between 60 and 90 days to prepare the database examination.

...

Section 12. The Announcement shall enter into force on February 4, 2006, and shall apply to controlled transactions made in income years beginning on or after January 1, 2006..."

The OECD Guidelines on Transfer Pricing (2010) state, among other things:

"Chapter I

The Arm's Length Principle

...

B. Statement of the arm's length principle

B.1 Article 9 of the OECD Model Tax Convention

1.6 The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member countries and an increasing number of non-member countries...

By seeking to adjust profits by reference to the conditions which would have been obtained between independent enterprises in comparable transactions and comparable circumstances (i.e. in "comparable uncontrolled transactions"), the arm's length principle follows the approach of treating the members of an MNE group as operating as separate entities rather than as inseparable parts of a single unified business. Because the separate entity approach treats the members of an MNE group as if they were independent entities, attention is focused on the nature of transactions between those members and on whether the conditions thereof differ from the conditions that would be obtained in comparable uncontrolled transactions. Such an analysis of the controlled and uncontrolled transactions, which is referred to as a "comparability analysis", is at the heart of the application of the arm's length principle. Guidance on the comparability analysis is found in Section D below and in Chapter III.
...

D. Guidance for applying the arm's length principle

D.1 Comparability analysis

D.1.1 Significance of the comparability analysis and meaning of "comparable"

1.33 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. For such comparisons to be useful, the economically relevant characteristics of the situations being compared must be sufficiently comparable. To be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology (e.g., price or margin), or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. In determining the degree of comparability, including what adjustments are necessary to establish it, an understanding of how independent enterprises evaluate potential transactions is required. Detailed guidance on performing a comparability analysis is set forth in Chapter III.

1.34 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. For example, one enterprise is unlikely to accept a price offered for its product by an

independent enterprise if it knows that other potential customers are willing to pay more under similar conditions. This point is relevant to the question of comparability since independent enterprises would generally take into account any economically relevant differences between the options realistically available to them (such as differences in the level of risk or other comparability factors discussed below) when valuing those options. Therefore, when making the comparisons entailed by application of the arm's length principle, tax administrations should also take these differences into account when establishing whether there is comparability between the situations being compared and what adjustments may be necessary to achieve comparability.

1. 35 All methods that apply the arm's length principle can be tied to the concept that independent enterprises consider the options available to them and in comparing one option to another they consider any differences between the options that would significantly affect their value. For instance, before purchasing a product at a given price, independent enterprises normally would be expected to consider whether they could buy the same product on otherwise comparable terms and conditions but at a lower price from another party. Therefore, as discussed in Chapter II, Part II, the comparable uncontrolled price method compares a controlled transaction to similar uncontrolled transactions to provide a direct estimate of the price the parties would have agreed to had they resorted directly to a market alternative to the controlled transaction. However, the method becomes a less reliable substitute for arm's length transactions if not all the characteristics of these uncontrolled transactions that significantly affect the price charged between independent enterprises are comparable. Similarly, the resale price and cost-plus methods compare the gross profit margin earned in the controlled transaction to gross profit margins earned in similar uncontrolled transactions. The comparison provides an estimate of the gross profit margin one of the parties could have earned had it performed the same functions for independent enterprises and therefore provides an estimate of the payment that party would have demanded, and the other party would have been willing to pay, at arm's length for performing those functions. Other methods, as discussed in Chapter II, Part III, are based on comparisons of net profit indicators (such as profit margins) between independent and associated enterprises as a means to estimate the profits that one or each of the associated enterprises could have earned had they dealt solely with independent enterprises, and there- fore the payment those enterprises would have demanded at arm's length to compensate them for using their resources in the controlled transaction. Where there are differences between the situations being compared that could materially affect the comparison, comparability adjustments must be made, where possible, to improve the reliability of the comparison. Therefore, in no event can unadjusted industry average returns themselves establish arm's length conditions.
...

D.2 Recognition of the actual transactions undertaken

1.64 A tax administration's examination of a controlled transaction or- dinarily should be based on the transaction actually undertaken by the

associated enterprises as it has been structured by them, using the methods applied by the taxpayer insofar as these are consistent with the methods described in Chapter II. In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them. Restructuring of legitimate business transactions would be a wholly arbitrary exercise the inequity of which could be compounded by double taxation created where the other tax administration does not share the same views as to how the transaction should be structured.

D.3 Losses

1.70 When an associated enterprise consistently realizes losses while the MNE group as a whole is profitable, the facts could trigger some special scrutiny of transfer pricing issues. Of course, associated enterprises, like independent enterprises, can sustain genuine losses, whether due to heavy start-up costs, unfavorable economic conditions, inefficiencies, or other legitimate business reasons. However, an independent enterprise would not be prepared to tolerate losses that continue indefinitely. An independent enterprise that experiences recurring losses will eventually cease to undertake business on such terms. In contrast, an associated enterprise that realizes losses may remain in business if the business is beneficial to the MNE group as a whole.

...

Chapter II

Transfer Pricing Methods

Part I: Selection of the transfer pricing method

A. Selection of the most appropriate transfer pricing method to the circumstances of the case

2.1 ... Traditional transaction methods are the comparable uncontrolled price method or CUP method, the resale price method, and the cost-plus method. Transactional profit methods are the transactional net margin method and the transactional profit split method.

2.2 The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case. For this purpose, the selection process should take account of the respective strengths and weaknesses of the OECD recognized methods; the appropriateness of the method considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; the availability of reliable information (in particular on uncontrolled comparables) needed to apply the selected method and/or other methods; and the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate material differences between them. ...

2.3 Traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and finan-

cial relations between associated enterprises are arm's length. This is because any difference in the price of a controlled transaction from the price in a comparable uncontrolled transaction can normally be traced directly to the commercial and financial relations made or imposed between the enterprises, and the arm's length conditions can be established by directly substituting the price in the comparable uncontrolled transaction for the price of the controlled transaction. As a result, where, taking account of the criteria described at paragraph 2.2, a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method. Moreover, where, taking account of the criteria described at paragraph 2.2, the comparable uncontrolled price method (CUP) and another transfer pricing method can be applied in an equally reliable manner, the CUP method is to be preferred. See paragraphs 2.13-2.20 for a discussion of the CUP method.

...

2.5 However, it is not appropriate to apply a transactional profit method merely because data concerning uncontrolled transactions are difficult to obtain or incomplete in one or more respects. The same criteria listed in paragraph 2.2 that were used to reach the initial conclusion that none of the traditional transactional methods could be reliably ap- plied under the circumstances must be considered again in evaluating the reliability of the transactional profit method.

...

2.7 In no case should transactional profit methods be used so as to result in over-taxing enterprises mainly because they make profits lower than the average, or in under-taxing enterprises that make higher than average profits. There is no justification under the arm's length principle for imposing additional tax on enterprises that are less successful than average or, conversely, for under-taxing enterprises that are more successful than average, when the reason for their success or lack thereof is attributable to commercial factors.

...

2.9 Moreover, MNE groups retain the freedom to apply methods not described in these Guidelines (hereafter "other methods") to establish prices provided those prices satisfy the arm's length principle in accordance with these Guidelines. Such other methods should however not be used in substitution for OECD-recognized methods where the latter are more appropriate to the facts and circumstances of the case. In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognized methods were regarded as less appropriate or nonworkable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution. A taxpayer should maintain and be prepared to provide documentation regarding how its transfer prices were established. ...

2.10 It is not possible to provide specific rules that will cover every case. Tax administrators should hesitate from making minor or marginal adjustments. In general, the parties should attempt to reach a reasonable accommodation keeping in mind the imprecision of the various meth-

ods and the preference for higher degrees of comparability and a more direct and closer relationship to the transaction. It should not be the case that useful information, such as might be drawn from uncontrolled transactions that are not identical to the controlled transactions, should be dismissed simply because some rigid standard of comparability is not fully met. Similarly, evidence from enterprises engaged in controlled transactions with associated enterprises may be useful in understanding the transaction under review or as a pointer to further investigation. Further, any method should be permitted where its application is agreeable to the members of the MNE group involved with the transaction or transactions to which the methodology applies and also to the tax administrations in the jurisdictions of all those members.

...

Part II: Transactional transaction methods

A. Introduction

2.12 This part provides a detailed description of traditional transaction methods that are used to apply the arm's length principle. These methods are the comparable uncontrolled price method or CUP method, the resale price method, and the cost-plus method.

...

C. Resale Price Method

C1 In general

2.21 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. This price (the resale price) is then reduced by an appropriate gross margin on this price (the "resale price margin") representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin 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. This method is probably most useful where it is applied to marketing operations.

...

2.25 Although broader product differences can be allowed in the resale price method, the property transferred in the controlled transaction must still be compared to that being transferred in the uncontrolled transaction. Broader differences are more likely to be reflected in differences in functions performed between the parties to the controlled and uncontrolled transactions. While less product comparability may be required in using the resale price method, it remains the case that closer comparability of products will produce a better result. For example, where there is a valuable or unique intangible involved in the transaction, product similarity may assume greater importance and particular attention should be paid to it to ensure that the comparison is valid.

2.26 It may be appropriate to give more weight to other attributes of comparability discussed in Chapter I (i.e., functions performed, econom- ic circumstances, etc.) when the profit margin relates primarily to those other attributes and only secondarily to the particular product being transferred. This circumstance will usually exist where the profit mar- gin is determined for an associated enterprise that has not used unique assets (such as valuable, unique intangibles) to add significant value to the product being transferred. Thus, where uncontrolled and controlled transactions are comparable in all characteristics other than the product itself, the resale price method might produce a more reliable measure of arm's length conditions than the CUP method, unless reasonably accurate adjustments could be made to account for differences in the prod- ucts transferred. The same point is true for the cost-plus method, dis- cussed below.
...

2.29 An appropriate resale price margin is easiest to determine where the reseller does not add substantially to the value of the product. In contrast, it may be more difficult to use the resale price method to arrive at an arm's length price where, before resale, the goods are further processed or incorporated into a more complicated product so that their identity is lost or transformed (e.g. where components are joined together in finished or semi-finished goods). Another example where the resale price margin requires particular care is where the reseller contributes substantially to the creation or maintenance of intangible property associated with the product (e.g., trademarks or trade names) which are owned by an associated enterprise. In such cases, the contribution of the goods originally transferred to the value of the final product cannot be easily evaluated.

2.30 A resale price margin is more accurate where it is realized within a short time of the reseller's purchase of the goods. The more time that elapses between the original purchase and resale the more likely it is that other factors - changes in the market, in rates of exchange, in costs, etc. - will need to be taken into account in any comparison.
...

2.35 Where the accounting practices differ from the controlled transaction to the uncontrolled transaction, appropriate adjustments should be made to the data used in calculating the resale price margin to ensure that the same types of costs are used in each case to arrive at the gross margin. For example, costs of R&D may be reflected in operating expenses or in costs of sales. The respective gross margins would not be comparable without appropriate adjustments.

Part III: Transactional profit methods

A. Introduction

2.56 This Part provides a discussion of transactional profit methods that may be used to approximate arm's length conditions where such methods are the most appropriate to the circumstances of the case, see para-

graphs 2.1-2.11. Transactional profit methods examine the profits that arise from particular transactions among associated enterprises. The only profit methods that satisfy the arm's length principle are those that are consistent with Article 9 of the OECD Model Tax Convention and follow the requirement for a comparability analysis as described in these Guidelines. In particular, so-called "comparable profits methods" or "modified cost plus/resale price methods" are acceptable only to the extent that they are consistent with these Guidelines.

2.57 A transactional profit method examines the profits that arise from particular controlled transactions. The transactional profit methods for purposes of these Guidelines are the transactional profit split method and the transactional net margin method. Profit arising from a controlled transaction can be a relevant indicator of whether the transaction was affected by conditions that differ from those that would have been made by independent enterprises in otherwise comparable circumstances.

B. Transactional net margin method

B.1 In general

2.58 The transactional net margin method examines the net profit relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realizes from a controlled transaction (or transactions that are appropriate to aggregate under the principles of paragraphs 3.9-3.12). Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods. This similarity means that in order to be applied reliably, the transactional net margin method must be applied in a manner consistent with the manner in which the resale price or cost-plus method is applied. ...

...

B.2 Strengths and weaknesses

2.62 One strength of the transactional net margin method 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. Differences in the functions performed between enterprises are often reflected in variations in operating expenses. Consequently, this may lead to a wide range of gross profit margins but still broadly similar levels of net operating profit indicators. In addition, in some countries the lack of clarity in the public data with respect to the classification of expenses in the gross or operating profits may make it difficult to evaluate the comparability of gross margins, while the use of net profit indicators may avoid the problem.

...

2.64 There are also a number of weaknesses to the transactional net margin method. 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 provide some detailed guidance on establishing comparability for the transactional net margin method ...
...

B.3 Guidance for application

B.3.1 The comparability standard to be applied to the transactional net margin method

2.68 A comparability analysis must be performed in all cases in order to select and apply the most appropriate transfer pricing method, and the process for selecting and applying a transactional net margin method should not be less reliable than for other methods. As a matter of good practice, the typical process for identifying comparable transactions and using data so obtained which is described at paragraph 3.4 or any equivalent process designed to ensure robustness of the analysis should be followed when applying a transactional net margin method, just as with any other method. That being said, it is recognized that in practice the level of information available on the factors affecting external comparable transactions are often limited. Determining a reliable estimate of an arm's length outcome requires flexibility and the exercise of good judgment ...

2.69 Prices are likely to be affected by differences in products, and gross margins are likely to be affected by differences in functions, but net profit indicators are less adversely affected by such differences ...

2.70 ... In the traditional transaction methods, the effect of these factors may be eliminated as a natural consequence of insisting upon greater product and function similarity. Depending on the facts and circumstances of the case and in particular on the effect of the functional differences on the cost structure and on the revenue of the potential comparables, net profit indicators can be less sensitive than gross margins to differences in the extent and complexity of functions and to differences in the level of risks (assuming the contractual allocation of risks is arm's length). On the other hand, depending on the facts and circumstances of the case and in particular on the proportion of fixed and variable costs, the transactional net margin method may be more sensitive than the cost plus or resale price methods to differences in capacity utilisation, because differences in the levels of absorption of indirect fixed costs (e.g. fixed manufacturing costs or fixed distribution costs) would affect the net profit indicator but may not affect the gross margin or gross mark-up on costs if not reflected in price differences ...
...

2.75 Another important aspect of comparability is measurement consistency. The net profit indicators must be measured consistently between the associated enterprise and the independent enterprise. In addition, there may be differences in the treatment across enterprises of operating expenses and non-operating expenses affecting the net profits such as depreciation and reserves or provisions that would need to be accounted for in order to achieve reliable comparability.
...

B.3.3 Determination of the net profit

...

2.78 Costs and revenues that are not related to the controlled transaction under review should be excluded where they materially affect comparability with uncontrolled transactions. An appropriate level of segmentation of the taxpayer's financial data is needed when determining or testing the net profit it earns from a controlled transaction (or from transactions that are appropriately aggregated according to guidance at paragraphs 3.9-3.12). Therefore, it would be inappropriate to apply the transactional net margin method on a company-wide basis if the company engages in a variety of different controlled transactions that cannot be appropriately compared on an aggregate basis with those of an independent enterprise.

...

2.80 Non-operating items such as interest income and expenses and income taxes should be excluded from the determination of the net profit indicator. Exceptional and extraordinary items of a non-recurring nature should generally also be excluded. This however is not always the case as there may be situations where it would be appropriate to include them, depending on the circumstances of the case and on the functions being undertaken and the risks being borne by the tested party. Even where exceptional and extraordinary items are not taken into account in the determination of the net profit indicator, it may be useful to review them because they can provide valuable information for the purpose of comparability analysis (for instance by reflecting that the tested party bears a given risk).

...

B.3.4.1 Cases where the net profit is weighted to sales

2.90 A net profit indicator of net profit divided by sales, or net profit margin, is frequently used to determine the arm's length price of purchases from an associated enterprise for resale to independent customers. In such cases, the sales figure at the denominator should be the re-sales of items purchased in the controlled transaction under review. Sales revenue that is derived from uncontrolled activities (purchase from independent parties for re-sale to independent parties) should not be included in the determination or testing of the remuneration for controlled transactions, unless the uncontrolled transactions are such that they do not materially affect the comparison; and/or the controlled and uncontrolled transactions are so closely linked that they cannot be evaluated adequately on a separate basis. One example of the latter situation can sometimes occur in relation to uncontrolled after-sales services or sales of spare parts provided by a distributor to independent end-user customers where they are closely linked to controlled purchase transactions by the distributor for resale to the same independent end-user customers, for instance because the service activity is performed using rights or other assets that are granted under the distribution arrangement. See also discussion of portfolio approaches in paragraph 3.10.

...

Chapter III

Comparability Analysis

A. Performing a comparability analysis

3.1 General guidance on comparability is found in Section D of Chapter I. By definition, a comparison implies examining two terms: the controlled transaction under review and the uncontrolled transactions that are regarded as potentially comparable. The search for comparables is only part of the comparability analysis. It should be neither confused with nor separated from the comparability analysis. The search for information on potentially comparable uncontrolled transactions and the process of identifying comparables is dependent upon prior analysis of the taxpayer's-controlled transaction and of the relevant comparability factors (see paragraphs 1.38-1.63). A methodical, consistent approach should provide some continuity or linkage in the whole analytical process, thereby maintaining a constant relationship amongst the various steps: from the preliminary analysis of the conditions of the controlled transaction, to the selection of the transfer pricing method, through to the identification of potential comparables and ultimately a conclusion about whether the controlled transactions being examined are consistent with the arm's length principle as described in para- graph 1 of Article 9 of the OECD Model Tax Convention.

...

A.3 Review of the controlled transaction and choice of the tested party

...

A.3.1 Evaluation of a taxpayer's separate and combined transactions

3.9 Ideally, to arrive at the most precise approximation of arm's length conditions, the arm's length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. Examples may include *1.* some long-term contracts for the supply of commodities or services, *2.* rights to use intangible property, and *3.* pricing a range of closely linked products (e.g., in a product line) when it is impractical to determine pricing for each individual product or transaction. Another example would be the licensing of manufacturing know-how and the supply of vital components to an associated manufacturer; it may be more reasonable to assess the arm's length terms for the two items together rather than individually. Such transactions should be evaluated together using the most appropriate arm's length method. A further example would be the routing of a transaction through another associated enterprise; it may be more appropriate to consider the transaction of which the routing is a part in its entirety, rather than consider the individual transactions on a separate basis.

...

A.3.3 Choice of the tested party

3.18 When applying a cost plus, resale price or transactional net margin method as described in Chapter II, it is necessary to choose the party to the transaction for which a financial indicator (markup on costs, gross margin, or net profit indicator) is tested. The choice of the tested party should be consistent with the functional analysis of the transaction. As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e., it will most often be the one that has the less complex functional analysis.

...

A.3.4 Information on the controlled transaction

...

3.22 Where the most appropriate transfer pricing method in the circumstances of the case, determined following the guidance at paragraphs 2.1-2.11, is a one-side method, financial information on the tested party is needed in addition to the information referred to in paragraph 3.20 - irrespective of whether the tested party is a domestic or foreign entity. So if the most appropriate method is a cost plus, resale price or transactional net margin method and the tested party is the foreign entity, sufficient information is needed to be able to reliably apply the selected method to the foreign tested party and to enable a review by the tax administration of the country of the non-tested party of the application of the method to the foreign tested party. On the other hand, once a particular one-sided method is chosen as the most appropriate method and the tested party is the domestic taxpayer, the tax administration generally has no reason to further ask for financial data of the foreign associated enterprise.

...

A.4 Comparable uncontrolled transactions

...

A.4.4 Use of non-transactional third-party data

A net profit indicator of net profit divided by sales, or net profit margin, is frequently used to determine the arm's length price of purchases from an associated enterprise for resale to independent customers. In such cases, the sales figure at the denominator should be the re-sales of items purchased in the controlled transaction under review. Sales revenue that is derived from uncontrolled activities (purchase from independent parties for re-sale to independent parties) should not be included in the determination or testing of the remuneration for con- trolled transactions, unless the uncontrolled transactions are such that they do not materially affect the comparison; and/or the controlled and uncontrolled transactions are so closely linked that they cannot be evaluated adequately on a separate basis. One example of the latter situation can sometimes occur in relation to uncontrolled after-sales services or sales of spare parts provided by a distributor to independent end-user customers where they are closely linked to controlled purchase transactions by the distributor for resale to the same independent end-user customers, for instance because the service activity is performed

using rights or other assets that are granted under the distribution arrangement. See also discussion of portfolio approaches in paragraph 3.10.

A.4.5 Limitations in available comparables

3.38 The identification of potential comparables has to be made with the objective of finding the most reliable data, recognizing that they will not always be perfect. For instance, independent transactions may be scarce in certain markets and industries. A pragmatic solution may need to be found, on a case-by-case basis, such as broadening the search and using information on uncontrolled transactions taking place in the same industry and a comparable geographical market, but performed by third parties that may have different business strategies, business models or other slightly different economic circumstances; information on uncontrolled transactions taking place in the same industry but in other geographical markets; or information on uncontrolled transactions taking place in the same geographical market but in other industries. The choice among these various options will depend on the facts and circumstances of the case, and in particular on the significance of the expected effects of comparability defects on the reliability of the analysis.

...

A.6 Comparability adjustments

3.47 The need to adjust comparables and the requirement for accuracy and reliability are pointed out in these Guidelines on several occasions, both for the general application of the arm's length principle and more specifically in the context of each method. As noted at paragraph 1.33, to be comparable means that none of the differences (if any) between the situations being compared could materially affect the condition being examined in the methodology or that reasonably accurate adjustments can be made to eliminate the effect of any such differences. Whether comparability adjustments should be performed (and if so, what adjustments should be performed) in a particular case is a matter of judgment that should be evaluated in light of the discussion of costs and compliance burden at Section C.

...

A.6.2 Purpose of comparability adjustments

Comparability adjustments should be considered if (and only if) they are expected to increase the reliability of the results. Relevant considerations in this regard include the materiality of the difference for which an adjustment is being considered, the quality of the data subject to adjustment, the purpose of the adjustment and the reliability of the approach used to make the adjustment.

...

A.7 Arm's length range

A.7.1 In general

3.55 In some cases, it will be possible to apply the arm's length principle to arrive at a single figure (e.g., price or margin) that is the most reliable to establish whether the conditions of a transaction are arm's length.

However, because transfer pricing is not an exact science, there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable. In these cases, differences in the figures that comprise the range may be caused by the fact that in general the application of the arm's length principle only produces an approximation of conditions that would have been established between independent enterprises. It is also possible that the different points in a range represent the fact that independent enterprises engaged in comparable transactions under comparable circumstances may not establish exactly the same price for the transaction.

3.56 In some cases, not all comparable transactions examined will have a relatively equal degree of comparability. Where it is possible to determine that some uncontrolled transactions have a lesser degree of comparability than others, they should be eliminated.

3.57 It may also be the case that, while every effort has been made to exclude points that have a lesser degree of comparability, what is arrived at is a range of figures for which it is considered, given the process used for selecting comparables and limitations in information available on comparables, that some comparability defects remain that cannot be identified and/or quantified, and are therefore not adjusted. In such cases, if the range includes a sizeable number of observations, statistical tools that take account of central tendency to narrow the range (e.g., the interquartile range or other percentiles) might help to enhance the reliability of the analysis.
...

A.7.2 Selecting the most appropriate point in the range
3.60 If the relevant condition of the controlled transaction (e.g., price or margin) is within the arm's length range, no adjustment should be made.

3.61 If the relevant condition of the controlled transaction (e.g. price or margin) falls outside the arm's length range asserted by the tax administration, the taxpayer should have the opportunity to present arguments that the conditions of the controlled transaction satisfy the arm's length principle, and that the result falls within the arm's length range (i.e. that the arm's length range is different from the one asserted by the tax administration). If the taxpayer is unable to establish this fact, the tax administration must determine the point within the arm's length range to which it will adjust the condition of the controlled transaction.

3.62 In determining this point, where the range comprises results of relatively equal and high reliability, it could be argued that any point in the range satisfies the arm's length principle. Where comparability defects remain as discussed at paragraph 3.57, it may be appropriate to use measures of central tendency to determine this point (for instance the median, the mean or weighted averages, etc., depending on the specific characteristics of the data set), in order to minimize the risk of error due to unknown or unquantifiable remaining comparability defects.
...

B.4 Data from years following the year of the transaction

B.5 Data from years following the year of the transaction may also be relevant to the analysis of transfer prices, but care must be taken to avoid the use of hindsight. For example, data from later years may be useful in comparing product life cycles of controlled and uncontrolled transactions for the purpose of determining whether the uncontrolled transaction is an appropriate comparable to use in applying a particular method. Subsequent conduct by the parties will also be relevant in ascertaining the actual terms and conditions that operate between the parties.

B.5 Multiple year data

3.75 In practice, examining multiple year data is often useful in a comparability analysis, but it is not a systematic requirement. Multiple year data should be used where they add value to the transfer pricing analysis. It would not be appropriate to set prescriptive guidance as to the number of years to be covered by multiple year analyses.

3.76 In order to obtain a complete understanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data from both the year under examination and prior years. The analysis of such information might disclose facts that may have influenced (or should have influenced) the determination of the transfer price. For example, the use of data from past years will show whether a taxpayer's reported loss on a transaction is part of a history of losses on similar transactions, the result of particular economic conditions in a prior year that increased costs in the subsequent year, or a reflection of the fact that a product is at the end of its life cycle. Such an analysis may be particularly useful where a transactional profit method is applied. ...
...

3.79 The use of multiple year data does not necessarily imply the use of multiple year averages. Multiple year data and averages can however be used in some circumstances to improve reliability of the range. ...

C. Compliance issues

3.80 One question that arises when putting the need for comparability analyses into perspective is the extent of the burden and costs that should be borne by a taxpayer to identify possible comparables and obtain detailed information thereon. It is recognized that the cost of information can be a real concern, especially for small to medium sized operations, but also for those MNEs that deal with a very large number of controlled transactions in many countries. ...

3.81 When undertaking a comparability analysis, there is no requirement for an exhaustive search of all possible relevant sources of information. Taxpayers and tax administrations should exercise judgment to determine whether particular comparables are reliable.

... 4.9
In a difficult transfer pricing case, because of the complexity of the facts to be evaluated, even the best-intentioned taxpayer can make an honest mistake. Moreover, even the best-intentioned tax examiner may draw the wrong conclusion from the facts. Tax administrations are encouraged to take this observation into account in conducting their transfer pricing examinations. This involves two implications. First, tax examiners are encouraged to be flexible in their approach and not demand from taxpayers in their transfer pricing a precision that is unrealistic under all the facts and circumstances. Second, tax examiners are encouraged to take into account the taxpayer's commercial judgment about the application of the arm's length principle, so that the transfer pricing analysis is tied to business realities. Therefore, tax examiners should undertake to begin their analyses of transfer pricing from the perspective of the method that the taxpayer has chosen in setting its prices. The guidance provided in Chapter II, Part I dealing with the se- lection of the most appropriate transfer pricing method also may assist in this regard."

The right to discretionary assessment of income

The current provisions in section 3 B, subsection 8 and section 5, subsection 3 of the Danish Tax Control Act are as follows:

"**Section 3 B...**
Subsection 8. If the taxpayer has not prepared documentation pursuant to subsection 5 or 6, section 5, subsection 3 shall apply with regard to the controlled transactions.
...

Section 5...
Subsection 3. If a tax return is not available at the time of assessment, the tax assessment may be estimated."

Section 3 B, subsection 8 (then subsection 5), was inserted by Act no. 131 of February 25, 1998, amending the Danish Tax Control Act and the Danish Tax Administration Act. From the general comments to the bill, see proceedings of the Danish Parliament 1997-98 (1st session), Appendix A, page 1898f, it appears, inter alia:

"*The background to transfer pricing rules*
...

It is significantly easier to secure the necessary documentation at the same time as the internal transactions are made, instead of having to obtain the documentation afterwards. Subsequent procurement is further complicated by the fact that the basis of comparison for assessing whether the internal transactions have been made in accordance with the arm's length principle is often not complete.

> If information to assess whether the internal transactions have been made in accordance with the arm's length principle is not submitted by a company in Denmark, this may, according to the general burden of proof rules, result in procedural damage to the company in Denmark. This means that the burden of proof for the tax authorities is weakened. Regardless of the weakening of the burden of proof, the tax authorities must still make it probable that the transaction did not take place on arm's length terms. This can be particularly difficult where part of the basis of comparison is missing because it originates from the foreign company or because a number of years have passed. By requiring a documentation basis in the company in Denmark, the tax authorities' work is made easier, and the company is aware of what documentation will be required if a transfer pricing case is initiated.
>
> If the taxpayer has not prepared documentation in accordance with subsection (4), section 5(3) shall apply in respect of the controlled transactions. The taxable income relating to the controlled transactions may then be determined on a discretionary basis. This corresponds to what applies to a failure to comply with the accounting requirements in the Minimum Requirements Order.
>
> In all cases where the tax authorities wish to change the taxable income in accordance with an estimate of what could have been obtained if the transactions were concluded between independent parties, prior approval must be obtained from the Central Customs and Tax Administration. The taxable income may be amended if the tax authority is of the opinion that the fixed prices and terms are not at arm's length or if the documentation is not a sufficient basis for the prices. However, the individual case must be submitted to the central customs and tax administration for approval before the discretionary change is made. If the taxpayer is of the opinion that the change is unjustified, the taxpayer must prove that the transaction was made on arm's length terms. This means that the burden of proof may shift between the taxpayer and the tax authorities, depending on the circumstances. Ultimately, the assessment of evidence is subject to judicial review."

In the bill's comments to the proposed section 3 B, subsection (5) (now subsection (8)), cf. Danish Official Gazette 1997-98 (1st session), Appendix A, page 1909, it is stated, inter alia:

> "The proposed rules will make it possible for the tax authority to investigate and assess the companies' determination of price and terms. By requiring a documentation basis to be prepared, the determination is brought "into the light" and furthermore, there will in future be no doubt that companies have a duty to document the determination of price and terms.
>
> According to the general rules on free assessment of evidence in Danish law, cf. section 344 of the Danish Administration of Justice Act, failure to provide such information may have a detrimental effect on evidence. The assessment of the consequences for the companies if they do not fulfill their documentary obligations will be

subject to the ordinary review of the courts.

The tax authority must in all cases - before any correction of the taxable income is made - contact the taxpayers in order to obtain the necessary documentation.

A correction of the taxable income must be justified. The tax authorities must state the factors they have taken into account when determining the price and the method they have used to calculate it.

The tax authorities' assessment of whether the taxpayer's pricing is in accordance with the arm's length principle and whether the documentation prepared is a sufficient basis for this will be made in accordance with the principles of the OECD transfer pricing guidelines."

In the bill which led to amendments to section 3 B by Act no. 408 of June 1, 2005, the following, among other things, is stated in the general remarks, see proceedings of the Danish Parliament 2004-05 (2nd session), Appendix A, page 4909f):

"*2. Applicable rules*

...

If the taxpayer has not prepared documentation, the tax authorities may, according to section 3 B (5) of the current Danish Tax Control Act, make a discretionary assessment with regard to the controlled transactions. In addition, a failure to fulfill the documentation obligation may lead to a reversal of the burden of proof, so that the taxpayer must prove that the transactions are arm's length.

As mentioned, the consequence of insufficient documentation is, among other things, that the tax authorities (customs and tax administration) are entitled to make an estimate on the best possible basis that the tax authorities (customs and tax administration) can find.
The assessment must always be exercised in accordance with the principles of the OECD transfer pricing guidelines, which state, among other things, that the tax authorities (customs and tax administration) should not make marginal increases. Where possible, an increase could, for example, be based on a database investigation based on information from commercial databases (e.g., accounting information from the Danish Business Information Bureau or from the Amadeus database).

The fact that the tax authorities (customs and tax administration) have the right to make an estimate does not mean that a discretionary assessment is automatically made. Such a discretionary increase of income will be made if the tax authorities (customs and tax administration) assess that the transactions have not been on arm's length terms. This will always depend on a specific assessment,

> including, for example, whether it is a group company with reasonable earnings or, conversely, a group company that has had low or negative earnings for a long period of time without any clear business justification for this. In this regard, it should be noted that independent companies, for example, will not accept losses year after year. In such situations, the activity will cease."

Arguments
In support of its claim, **the Danish Ministry of Taxation** has in particular stated that three factors individually and together lead to the conclusion that EET Group has not acted at arm's length when pricing the company's intra-group transactions with the sales companies, and that the Danish Tax Agency was therefore entitled to estimate the income from the controlled transactions.

Firstly, EET Group (and the Danish National Tax Tribunal) have applied a gross margin method at company level that is not one of the five recognized methods in the OECD Transfer Pricing Guidelines (hereinafter TPG).

Secondly, EET Group's transfer pricing documentation for the disputed income years 2010, 2011 and 2012 is so flawed that it does not allow for a verification of the controlled transactions and thus does not meet the documentation requirement in section 3 B (5) of the Danish Tax Control Act.

Third, EET Group has not used the interquartile range (the distance between the 1st quartile and the 3rd quartile) to determine arm's length prices. Instead, EET Group has used the full range of the benchmark as an expression of an arm's length price.

The discretionary access
The TPG contains five methods, see TPG 2017, sections 2.2 and 2.9, to be used to assess whether controlled transactions comply with the arm's length principle, unless the taxpayer comes up with a better method.

It follows from the Supreme Court's case law that emphasis must be placed on the principles of the TPG, see e.g. UfR 2021.3179 H, where it appears from the premises that the discretion must always be exercised in accordance with the principles of the OECD Guidelines and that the taxpayer, when preparing its transfer pricing documentation, must do so taking into account that the tax authorities will apply the principles of the TPG in the assessment.

The OECD-recognized methods distinguish between the traditional transaction methods consisting of the CUP method, the resale price method, and the cost-plus method and the

transactional profit methods consisting of Transactional Net Margin Method ("TNM") and the profit split method, see TPG 2017, section 2.1.

EET Group states in this case that it applies the TNM method, which by definition is a net profit method, at gross profit level. Thus, the company does not apply the TNM method, but a gross profit method at company level, which is not described in the TPG. When TNM is at net level, the company cannot use it at gross level.

Choosing a method other than the OECD-recognized methods can only be done under very specific conditions. Thus, it follows from the TPG that it is a prerequisite for using other methods that they are not used as a substitute for an OECD-recognized method where this is more appropriate, and that the choice is supported by an explanation of why an OCED-recognized method in the applicable situation is less appropriate or not applicable and why the chosen method was considered a better method. However, neither EET Group nor the Danish National Tax Tribunal has done so. Thus, EET Group has not met its burden of proof that its method is better than one of the five recognized methods. Nor has the company explained why its method is better than the TNM method.

When EET Group has not lifted the burden of proof that the applied gross profit method at company level is better than the five recognized methods in the TPG and on arm's length terms, the consequence is that one of the five recognized methods under the TPG must be used. In this connection, the Danish Tax Agency has used the OECD-recognized TNM method to estimate the income, which is also the method that the company found most applicable in its transfer pricing documentation. It is then incumbent on EET Group to prove that the Danish Tax Agency's method is not applicable, see UfR 2023.471 H. The fact that the Danish National Tax Tribunal has applied the company's method in its decision does not change this.

EET Group has argued that its methodology corresponds to its "actual pricing of intra-group sales of goods, which is done using the cost-plus method". However, this does not explain the company's use of a gross profit method rather than the TPG-recognized methods. In addition, EET Group has argued that it sells products with relatively low unit prices and relatively high gross margins. This does not mean that it is more reliable to test the arm's length price at gross level than at net level. It is not even explained why this relationship should matter.

In support of the EET Group selling products with high gross margins, EET Group has referred to sales material from 2010.

Similarly, EET Group refers to the fact that the EET Group had a centralized IT platform and common back-office functions such as logistics, inventory, finance, and marketing, and that these functions have led to increased earnings. However, these are all functions that belong to EET Group and therefore do not explain the company's gross profit methodology. The company's statements therefore contradict the company's own description of local sales companies, which are precisely defined as low-risk companies that only perform sales activities and own no significant assets or IP.

In summary, EET Group has not demonstrated that a gross profit method is more applicable than the five recognized methods in TPG. The gross profit method is actually worse than the TNM method chosen by the Danish Tax Agency, as the use of the resale price method requires a high degree of comparability between a tested party and the benchmark companies, which also means that the benchmark companies must have a high degree of comparability among themselves.

Differences in both the functions performed by companies and accounting practices in different countries are often reflected in variations in operating expenses ("OPEX") and in wide ranges of gross profits. If such variations in OPEX and/or wide ranges of gross margins are observed, it is - conversely - an indication of possible significant differences in functions and/or accounting practices.

A review of EET Group's benchmark study for the 2011- and 2012-income years shows that there are significant differences in the gross profit margins and OPEX of the benchmark companies. When compared at the gross profit level, there are quite significant deviations between the points in the range from 9.2% to 34.5% in the 2011 income year and 2.4% and 28.9% in the 2012 income year. The large fluctuations in gross margins are in themselves a strong indicator that EET Group's gross profit method is not the most suitable. This is especially true as the sales companies are described in the transfer pricing documentation as low-risk distributors, as the earnings of such companies are usually expected to be low and stable according to recognized financial economic models. When comparing at the net profit level instead, the deviations are marginally smaller in the individual years (approx. 7-10 percentage points) and are even within the same percentage points over the years. This shows that a net profit method is more appropriate than the gross profit method.

In addition to gross margin percentages, the Danish Tax Agency has also analyzed the benchmark companies' operating costs in relation to revenue. The larger the

operating costs are in relation to revenue, the smaller the operating profit (EBIT) and thus the profit on the activity. When tested against companies that do not have a cost structure comparable to that of the EET companies, a "skewed" comparability analysis is obtained. This is especially the case if there is also a very large difference in the cost structure of the benchmark companies. If operating costs are very different, it is a strong indication that there may be different functions and/or multiple functions among the benchmark companies that cannot be detected by reviewing websites or financial statements. These differences will typically also be reflected in varying gross margins. The benchmark companies' operating costs to revenue ratio in the 2011 benchmark varies between 8.5% and 31.9%, and the 1. and 3. quartile of the benchmark companies are 12,5% and 20,3%.

The significant differences in gross margin percentages and operating expense to revenue ratios suggest that there are significant differences in accounting practices and/or functions performed by the benchmark and EET sales companies. It is therefore more accurate to use the TNM method as this method is significantly less sensitive to these differences than the resale price method.

In this connection, it is not correct, as stated by the Danish National Tax Tribunal, that the possible differences in accounting policies have less significance for the arm's length interval, because the interval includes data from a significant number of companies. This is especially true because EET Group claims that the entire interval must be applied. In addition, the Danish National Tax Tribunal only considers the significance of the interval as a whole, i.e., for the benchmark companies. However, the differences exist both internally between the benchmark companies and between the sales companies and the benchmark companies, which the Danish National Tax Tribunal does not address.

It is also clearly stated in the TPG that in connection with a comparability analysis at gross profit level, adjustments must be made for any differences in accounting standards, cf. TPG 2017, section 2.41. When applying the resale price method, it is thus crucial that the costs are accounted for in the same way between the tested parties (the EET sales companies) and the independent comparable companies (the benchmark companies). There is no information in the case as to what is booked in the individual benchmark companies under the accounting items between revenue and net profit (EBIT) and where it is booked (above or below gross profit). This means that there is no evidence that the benchmark companies have booked the same accounts among themselves, or that the accounts of the benchmark companies correspond to the accounts of the EET sales companies. This uncertainty is always present in the resale price method, where it is the gross profit that is compared,

whereas the TNM method takes into account differences in accounting policies by measuring on a net level in the form of EBIT.

The case establishes that EET Group has "cleaned" the accounting figures for its own sales companies so that they follow the same accounting principles. It is then incumbent on EET Group to prove that similar adjustments should not also have been made for the benchmark companies. Meanwhile, EET Group has neither been able to explain nor document that the same - or other - comparability defects cannot also be assumed to exist for the benchmark companies. This leads to the conclusion that EET Group's gross profit method applied as a whole for all of EET Group's 400,000 different product numbers cannot be applied in practice either.

On the present basis, there is thus no documentation that EET Group's adjustments of the sales companies' accounts have made them more comparable with the benchmark companies. On this basis, the Danish Tax Agency has been entitled to adjust the company's income in the income years 2010-2012, cf. section 2 of the Danish Tax Assessment Act. EET Group has not lifted its burden of proof that the Danish Tax Agency's assessment was made on an incorrect basis or is manifestly unreasonable, cf. UfR 2016.191H. Despite the objections that EET Group has had against the Danish Tax Agency's use of the TNM method, the company itself also uses the TNM method with the net margin as PLI as a secondary method in the transfer pricing documentation for the subsequent years.

Violation of the company's transfer pricing documentation
EET Group's transfer pricing documentation suffers from a number of deficiencies, which means that the Danish Tax Agency was also for this reason entitled to exercise an estimate of the income of EET Group, cf. section 3 B (8), cf. section 5(3), of the current Danish Tax Control Act.

In the judgment, which is reproduced in UfR 2019.1446H, the Supreme Court has ruled that transfer pricing documentation that is so significantly deficient that it does not provide the tax authorities with a sufficient basis for assessing whether the arm's length principle has been complied with, must be equated with missing documentation.

In this case, EET Group has several issues with its basis of comparison that lead to a lack of transparency.

Firstly, the sales companies have not only made intra-group purchases but have also purchased goods for resale from external suppliers. However, the turnover stated in the transfer pricing documentation is the total turnover, i.e., the turnover from the resale of both internally and externally purchased goods. This means that the gross margin that EET Group tests in

the transfer pricing documentation is obtained from the resale of both internally and externally purchased goods.

Based on the transfer pricing documentation, the tax authorities must be able to assess whether the intra-group transactions are at arm's length. When internal and external transactions in the transfer pricing documentation are mixed and thus tested together, it is not possible to make such an assessment, which is why the documentation is deficient, cf. also the Supreme Court's judgment in UfR 2021.3179H.

The fact that revenue from non-controlled transactions (external purchases) is included in the assessment of whether the controlled transactions (internal purchases) are at arm's length also leads to incorrect results. This is particularly evident as the sales companies earn significantly more on internal transactions than on the external transactions. This is illustrated, for example, by the Norwegian sales company earning significantly more on the goods that the sales company buys internally from EET Group and sells externally than on the goods that it buys externally and sells externally. This in itself shows that the internal prices are not at arm's length.

Secondly, in its benchmark studies, EET Group has not had the available data to test at gross profit level, which is why the company has calculated synthetic gross profits.

Gross profit is calculated as revenue less cost of goods sold (COGS). COGS includes, but is not limited to, material costs ("Material Costs"). The gross margin is calculated as gross profit divided by revenue, and the lower the COGS deducted when calculating gross profit, the higher the gross margin.

According to EET Group, the synthetic gross profits are calculated by deducting "Material Costs" from revenue, but the company has not documented what the accounting item "Material Costs" for the individual benchmark companies contains and whether the item is comparable with the EET sales companies' accounting item "consumption of goods".

The Danish National Tax Tribunal found that the company's calculation of gross profits could not in itself justify a rejection of the method as a basis for the arm's length assessment. In addition, it should be noted that a lack of reliable data must of course justify that the transfer pricing documentation is inadequate, just as the lack of data leads to the chosen method being inapplicable.

Thirdly, in the 2010 and 2011 tax years, EET Group has applied different selection criteria in relation to the companies' functions, assets

and risks. In the 2010 and 2011 benchmark study, companies with an inventory of at least 5% and no more than 25% of turnover were included, even though none of the EET sales companies - with the possible exception of Norway and Spain - had their own inventory. Conversely, the 2012 benchmark study only included companies with a weighted inventory of less than 3.5%, which means that not a single company that was part of the 2010 and 2011 study is included in the 2012 study.

For a comparability analysis to be meaningful, the selection criteria for the benchmark companies must reflect the functional, asset and risk analysis of the tested party, here the EET sales companies. However, in the income years 2010 and 2011, none of the sales companies meet the applied selection criterion. The functions and risks of the benchmark and sales companies are therefore not comparable.

The different functions arise from the fact that all benchmark companies have significant inventory, which the sales companies do not. As a result of a larger inventory, all benchmark companies will have a significant inventory risk, which the sales companies do not have. The greater the risk, the more you have to earn - and conversely, the lower the risk, the less you have to earn.

The benchmark for 2010 and 2011 thus includes companies with a non-comparable inventory, and it is not correct when this is apparently used by the Danish National Tax Tribunal as an argument for eliminating non-comparability. Nor has the Danish National Tax Tribunal explained in detail why the fact that the Group's own companies do not meet the selection criteria is of no significance.

For the 2012 income year, the selection criterion was changed so that the inventory in relation to turnover was between 0% and 3.5%, which is more comparable to the sales companies' inventory in relation to turnover. EET Group has not explained - and the Danish National Tax Tribunal has not commented on this - why the selection criterion is changed from 2010 and 2011 to 2012. The change means that none of the companies that were comparable in 2010 and 2011 are comparable in 2012. It is therefore not possible to find a single company that is comparable with the sales companies in both the 2010- and 2011-income years and the 2012 income year. The change means that the benchmark companies in 2010 and 2011 have a significantly different functional and risk profile than the benchmark companies included in 2012.

Similarly, there is a change in the selection criteria for intangible assets from 2010 and 2011 to 2012. In the benchmark study for 2010 and 2011, companies with up to 5% intangible assets are included,

even though none of the EET sales companies have booked intangible assets, while in the 2012 benchmark study no intangible assets are allowed.

Fourthly, in its transfer pricing documentation, EET Group has made adjustments to the gross margins of EET sales companies but has not made corresponding adjustments to the gross margins of the benchmark companies. Thus, there is a lack of transparency in the basis of comparison when EET Group "cleans" its own, but not the benchmark companies' gross margins.

The benchmark studies also suffer from a number of additional errors, including the fact that the 2010 study used market data for 2005-2007. The usual practice in preparing such studies is to use the three immediately preceding years (as in the company's 2011 study), or possibly the year in question and the two immediately preceding years (as in the company's 2012 study). EET Group has not provided any explanation as to why the company for each of the three disputed income years changes the principle for which years are used, just as the company has not provided any "solid" explanation as to why years 3-5 years prior to the income year in question were used for the 2010 study.

EET Group has subsequently presented a new benchmark study for 2010, which is based on market data for 2007-2009. However, the benchmark in this study is based on the same selection criteria as those used in the database study for 2010 and 2011, and thus selection criteria that EET Group itself believes are not comparable in the 2012 income year.
The company's statement that it used the "most appropriate search criteria" is therefore incorrect. The search criteria in the different income years - which are mutually exclusive - cannot be true and fair at the same time when the sales companies' circumstances are otherwise unchanged in the same income year.

It is therefore irrelevant to the disregard of EET Group's transfer pricing documentation that with the supplementary database study for the income year 2010 the company now uses market data for the years 2007-2009 instead of market data for 2005-2007. EET Group has thus not refuted the Ministry's conclusion that the company's 2010 benchmark study should be disregarded.

In summary, the basis of comparison in EET Group's transfer pricing documentation for the income years 2010, 2011 and 2012 suffers from a number of serious deficiencies, which means that the transfer pricing documentation must be disregarded as deficient, see e.g., UfR 2021.3179H. It follows that the tax authorities have been entitled to estimate the income from the controlled transactions, cf. section 3 B (8), cf. section 5(3), of the current Danish Tax Control Act.

The Interquartile range
EET Group argues that there is no basis for using the interquartile range in their pricing of the controlled transactions. This is not correct and the lack of use of the interquartile range, without any specific evidence to support it, in itself shows that there was no arm's length transaction.

Thus, there is no evidence in the case that the full interval should be applied. On the contrary, the Danish Tax Agency's - and the Danish National Tax Tribunal's - use of the interquartile range is fully in accordance with TPG and general practice among companies, advisors, and tax authorities.

Even though the process of selecting the comparable prices is carried out as well as possible, it will still occur that the basis for comparison is not perfect, cf. TPG 2017, section 3.57. Among other things, limitations in the information available when searching the data basis may result in the basis of comparison containing comparability errors.

In practice, the basis of comparison will always contain comparability errors, which is due to the method used to select the companies included in a database survey. In the search process, it is not possible by reviewing accounting databases, websites etc. to identify all the necessary information about the companies to ensure that the companies are perfectly comparable with regard to the five comparability factors: 1) contract terms, 2) functions, assets and risks, 3) product or service characteristics, 4) economic and market conditions and 5) business strategies. All of the relevant information is simply not available, and it is therefore common practice among both taxpayers (companies and their advisors) and tax authorities to use statistical methods - generally the interquartile range - to increase the reliability of the benchmark.

The practical application of the interquartile range is further supported by the proposal for a Council Directive on transfer pricing presented in September 2023. Article 12 of the proposal states that the interquartile range shall be applied as a general rule unless the taxpayer or the tax authority proves otherwise, and the introductory comments to Article 12 state that this is in line with best international practice.

The Danish Tax Agency has also examined the practice of companies and advisors regarding the use of the interquartile range and the full range, respectively. The conclusion of the study is that the interquartile range is used in 95 percent of the analyzed transactions and the full range in 5 percent of the transactions, and that the full range is typically only used in cases where the

present party's results are outside the interquartile range. The conclusion is also that in cases where database studies are used, the TNM method (97 percent) is by far the most used transfer pricing method. In addition, the study shows that the majority (61 percent) of the investigated database studies were conducted with a population of between 5 and 15 companies.

Therefore, it is fully consistent with theory and practice, including EET Group's own investigation thereof, that the Danish Tax Agency (and the Danish National Tax Tribunal) has applied the interquartile range. It is EET Group's burden of proof that it is an expression of arm's length price when the pricing of the controlled transactions has not been made using the interquartile range. This burden of proof has not been met.

In benchmark studies, there will almost by definition be a lack of comparability, and when EET Group wants to use the full range, the company must provide very strong evidence that the benchmark companies are fully comparable. The company has not even attempted to provide such evidence. On the contrary, the EET Group itself admits in several places that it was not possible to find perfectly comparable companies in the database searches. The company's use of the full range is therefore already excluded.

Specifically, there are also such uncertainties in relation to the comparability of the benchmark companies that - with the support of TPG - there is a basis for narrowing the arm's length interval. There is thus a significant difference between the selected benchmark companies and the EET sales companies in relation to the inventory function and inventory risk. Partly as a result of this, the benchmark companies have a significantly higher cost percentage below the gross margin level than the EET sales companies. This fact, coupled with the correlation between gross margin percentage and cost percentage, means that the benchmark companies are not fully comparable with the EET sales companies.

The fact that only 7 companies were compared in the benchmark study for 2012 cannot lead to a different result. For comparison, reference can be made to the Eastern High Court's judgment reproduced in SKM 2023.628Ø (appealed), where the Danish Tax Agency had found 9 comparable companies and then used the interquartile range to determine the arm's length interval, which the High Court found could not be set aside. Reference can also be made to the above-mentioned study from the Danish Tax Agency, which states that the interquartile range is also used in the case of smaller populations.

In addition, EET Group has not documented that it is a market condition that the sales companies' earnings must be above the interquartile range. It is EET Group's burden of proof to document the importance of the local sales companies. This importance is not documented by the company's reference to the group's product mix, high gross margin, and economies of scale. On the contrary,

the sales material presented by the company supports that the development of the group can be attributed to EET Group. The product portfolio, including the development of own products, the centralized IT platform and the centralized warehouse are all functions that belong to EET Group. This supports that it is not arm's length when the sales companies' earnings are above the interquartile range.

Furthermore, there is no evidence in the statement of assessment that the use of the interquartile range in the transfer pricing regulation of EET Group is unjustified. Nor has EET Group stated anything that would entitle it to deviate from the calculation method ("QUARTILE.INC"), which EET Group's advisors have themselves consistently and repeatedly used (and continue to use) in the transfer pricing documentation, and which has not previously been disputed, in favor of another method. Even if a different method is to be used, the company has not provided any evidence that this different method should be "QUARTILE.EXC".

Specifically, the full range is also so wide that abnormal results could be accepted as arm's length conditions if applied. For the 2010 financial year, the width of the full range for the benchmark companies is 10.3% at EBIT level and 25.3% at gross profit level. For the 2012 income year, the width of the full range is 6.9% at EBIT level and 26.6% at gross profit level.

It should also be noted that if the gross margin of all sales companies is set to minimum ([redacted]) for the 2011 income year, the sales companies together achieve an EBIT margin of -1.9 percent. If the full range is used, it would thus be acceptable as an arm's length condition that the sales companies made losses on the trade. Conversely, if all the sales companies achieved a maximum gross margin ([redacted]), this would result in a significant profit at the expense of EET Group, resulting in large losses for this company.

This would clearly not be consistent with the principle that each party should be remunerated in accordance with the functions and risks assumed by the parties in the transaction. EET Group has also described the selling companies as low-risk companies with no significant assets and no ownership of intangible assets. An analysis of the sales companies' assets and functions will therefore not entitle the sales companies to such a high profit margin compared to the Danish parent company, which owns all the intangible assets.

In short, it is an absurd result if the sales companies, which are low-risk companies, could make a significant loss by using the full range. This simply means that all gross percentages in the company's benchmark - the full range - do not reflect market prices.

When this is the case, it is a simple necessity to narrow the field using statistical methods. The very large spread between the results clearly shows that the full range is too wide to be used in its entirety and thus in violation of section 2 of the Danish Tax Assessment Act.

The median

For the sales companies whose earnings have been outside the interquartile range, the Danish National Tax Tribunal has adjusted the earnings to the nearest quartile. This is not correct, and the Danish Ministry of Taxation argues that, in accordance with established practice, an adjustment to the median should be made instead. Neither the Danish National Tax Tribunal nor EET Group has thus demonstrated that there is a basis for applying a different point in the interquartile range when, as in this case, there is a basis for an adjustment.

The starting point according to TPG is that "measures of central tendency", typically the median, must be used in the adjustment, see TPG 2017, section 3.62. If this starting point is to be deviated from, so that a different point in the arm's length interval is used, e.g., the third quartile, a specific justification is required.

In its decision, the Danish National Tax Tribunal found that there are comparability defects in the database studies. It is the same factors, i.e., the comparability defects, which justify both the use of a narrowed interval when assessing which transactions to adjust, and that the assessment (as a starting point) must be adjusted to the median, a weighted average or similar.

The Danish Tax Appeals Agency had also recommended to the Danish National Tax Tribunal that the increase should be made to the median. However, the Danish National Tax Tribunal deviated from the starting point and adjusted the income to the nearest point in the interquartile range (here the third quartile). The Danish National Tax Tribunal merely referred to the fact that the sales companies perform distributor functions that are functionally comparable to the companies within the arm's length interval, and that the Danish Tax Agency had not proven that the companies within the arm's length interval did not have earnings on arm's length terms. However, the fact that the sales companies perform distributor functions that are "functionally comparable to the selected companies within the arm's length range" is the very prerequisite for the selection of the benchmark companies. If the benchmark companies were not functionally comparable to a certain extent, they would not have been included in the benchmark at all - it is a "sine qua non". A reference to a certain functional comparability cannot justify an adjustment to the nearest point in the interquartile range.

It is also an error that the Danish National Tax Tribunal places the burden of proof on the Danish Tax Agency. It is not up to the Danish Tax Agency to (counter-)prove that all points in the interval are a "TP-

point". Instead, it is incumbent on the person who wants to deviate from the starting point in the TPG on the use of the median to provide evidence for this. Such proof is not available.

The adjustment to the median is also a lenient approach in this particular case, as the earnings of EET sales companies should actually be below the median as they are comparing to companies that have more functions and more risks, and therefore should be expected to earn more, including a higher gross margin.

Additional sales companies need to be increased
Based on updated database studies regarding the income years 2010 and 2011, it can be assumed that if these updated benchmark studies had been used in all of the disputed incomes, even an increase in gross profit would result in further increases than those made by the Danish National Tax Tribunal, as the vast majority of the sales companies' earnings fall outside the interquartile range. This also means that the Danish National Tax Tribunal's assessment, which is based on EET Group's benchmark, which is based on non-comparable selection criteria, has been made on an incorrect basis.

In support of its claims, **EET Group** has in particular stated that the arm's length principle and its regulation in section 2 of the Danish Tax Assessment Act and the TPG primarily entailed an obligation that EET Group's sale of goods to the sales companies should take place on similar terms as EET Group could have agreed regarding the sale of goods to independent sales companies under the same circumstances. The EET Group has fully complied with this obligation.

The Danish transfer pricing rules do not stipulate which principles the companies must use for pricing in intra-group transactions. The transfer pricing rules only require that the prices actually used must correspond to what independent parties could have agreed under the same circumstances, and that companies must test - using a suitable transfer pricing analysis method - whether the arm's length requirement i s met.

The pricing between EET Group and the sales companies was - and is - based on the cost-plus method. This pricing method corresponds to the industry standard and also to how the sales companies conduct their pricing towards their external customers.

In addition to the fact that the cost-plus method corresponds to how independent parties in the industry typically conduct pricing, the method is also suitable for ensuring compliance with the arm's length principle because it ensures that the supplier (specifically EET Group) covers the transaction-relevant costs as well as a profit margin element.

In the case, the EET Group's use of the cost-plus method for the actual pricing is well documented. The pricing between the EET Group and the sales companies has thus been based on a commercially well-founded method that is also suitable for ensuring arm's length conditions.

The EET Group has conducted its transfer pricing analysis based on the sales companies in order to test their purchase prices. Alternatively, EET could have sought to test EET Group's sales prices, but it was not practically possible to find a suitable basis for comparison.

As regards the test of the sales companies, in view of the preference for "internal comparable transactions", it was considered whether it was possible to conduct the analysis by comparing the sales companies' sales of goods purchased from EET Group with the sales companies' sales of goods purchased from external parties. However, due to an insufficient overlap of comparable transactions and the Group's use of the FIFO principle, such a comparison was not possible.

The EET Group therefore chose to perform the transfer pricing analysis by comparing the gross margins of the sales companies with the gross margins of comparable independent companies. This basic method of analysis is consistent with TPG and is similar to the resale price method. The choice of method was based on the fact that the resale price method basically tests gross margins, which is the basis for the actual pricing both in the industry in general and specifically at EET. Thus, the choice of method - in accordance with TPG 2010, section 2.10 - ensured the highest possible degree of proximity to the transaction.

For the transfer pricing analysis, the EET Group's advisors conducted extensive and detailed database analyses throughout the case period to identify a suitable basis of comparison (gross margins of suitable comparable companies). The transfer pricing analyses carried out showed that the sales companies of the EET Group achieved gross margins (the difference between sales prices and purchase costs as a percentage of turnover) corresponding to what comparable independent companies could achieve. As the sales companies sold their goods to independent parties without exception, the results of the analysis documented that the sales companies' purchase costs (related to the intra-group goods transactions) were overall at arm's length.

The fact that the sales companies in, [redacted] and [redacted] had no obvious purchases from external parties did not affect the robustness of the conclusion of the transfer pricing analysis. This was mainly due to the fact that EET Group offered all goods at the same prices to all sales companies. The uniform pricing together with the fact that the vast majority of the sales companies

were unaffected by external purchases and achieved gross margins at arm's length, leads to the clear conclusion that the pricing vis-à-vis the sales companies of, [redacted] and [redacted] was also at arm's length. In addition, the gross margins of these companies were also individually in line with the gross margins of the comparator companies.

Finally, it was found that the gross margins of the sales companies reflected the individual sales companies' product portfolios, so that the companies that sold a predominance of, for example, spare parts realized higher average margins than the sales companies that sold a predominance of easily marketable "branded goods". This income distribution also supported the conclusion that the intra-group transactions were conducted at arm's length.

In the application, the Danish Ministry of Taxation has stated that the EET Group's transfer pricing method is generally suitable for "the earnings from the controlled transactions to be wholly or partially placed in countries where the tax rate is lower." It must be noted that the Danish Ministry of Taxation's concern in this case is unfounded. The EET Group has thus paid approximately DKK 3 million more in corporate tax by paying tax in accordance with the EET Group's tax returns than if the EET Group had instead filed tax returns and paid tax in accordance with the corrections resulting from the Danish Tax Agency's decision.

The Danish Ministry of Taxation can then only agree that there is a basis for replacing EET Group's self-assessed income in relation to the intra-group sales transactions with the Danish Tax Agency's estimate if the Danish Ministry of Taxation proves that EET Group's transfer pricing documentation suffered from such serious deficiencies that the documentation should be equated with missing documentation.

In the present case, it is objectively established that EET Group's transfer pricing documentation was not deficient to such an extent that it can be set aside. Thus, the Danish Tax Agency only used the information in the transfer pricing documentation to assess both that, according to the Danish Tax Agency, the company had acted in violation of the arm's length principle and to assess what, according to the Danish Tax Agency, constituted arm's length conditions. For this reason alone, there is no basis for setting aside EET Group's transfer pricing documentation.

In addition, the criticism directed by the Danish Ministry of Taxation against EET Group's transfer pricing documentation is generally unjustified. Firstly, the Ministry has claimed that EET has used a method that contradicts the primary methods indicated by TPG. Secondly, the fact that the EET Group is not able to segment the income statements between goods purchased within the group and goods purchased outside the group should in itself constitute such a qualified deficiency that the transfer pricing documentation can be set aside.

Thirdly, that the fact that the EET Group did not narrow down the transfer pricing analysis to the interquartile range should constitute a similarly qualified deficiency. None of these objections are justified.

The Ministry's first objection - regarding the choice of method - is based on the view that EET Group in the transfer pricing documentation has stated that the transfer pricing analysis has been performed using the TNM method at gross profit level, which according to the Ministry is not possible, which is why the method is contrary to TPG. However, in the Danish Tax Agency's decision, the Danish Tax Agency characterizes the method used as the resale price method. Nowhere does it appear that the Danish Ministry of Taxation distances itself from this qualification, let alone on what basis it should be, if any. On the contrary, the Ministry states in the reply that "However, it seems that EET Group actually applies the resale price method at company level".

It is mostly a dispute of words whether the method used by EET Group is referred to as a TNM analysis at gross margin level or an analysis based on the resale price method. In all cases, any incorrect designation of the analysis method used is not such a qualified deficiency that it can lead to a disregard of the transfer pricing documentation, cf. the unappealed judgment of the Western High Court reproduced in SKM2020.397. In addition, it also follows from TPG 2010, section 2.9, that taxpayers are free to use alternative transfer pricing methods when these are more suitable than the classic methods recommended by the OECD in light of the taxpayer's specific facts and the available data basis. The objection is thus irrelevant to the case.

The Danish Ministry of Taxation's second objection is that it constitutes a qualified deficiency that the transfer pricing documentation does not include a segmentation of the income statements between goods purchased within the group and goods purchased outside the group. However, the Ministry's view is - if at all - only potentially relevant in relation to the sales companies in, and , as none of the other sales companies in the case period had external purchases of an extent that could in any way affect the income statement at either gross or net level. EET Group has furthermore demonstrated that it is impossible in practice to perform the segmentation requested by the Danish Ministry of Taxation in the specific case.

Even if segmentation could in principle be considered a matter that can be included and illustrated in a transfer pricing documentation, it must also be stated that the issue of segmentation also in relation to the companies in , and may constitute a relevant deficiency. This is because EET Group has applied the same prices to all sales companies at the same time as the other sales companies did not have external group purchases to such an extent

that could in any way affect the validity of the analysis results. As the transfer pricing analyses (also for these companies) showed that the intra-group trade was conducted at arm's length, the same must necessarily also be the case in relation to the companies in, [redacted] and when pricing was identical for all sales companies.

Finally, it is noted that the issue of segmentation has exactly the same relevance (or lack thereof) in relation to the TNM method preferred by the Danish Ministry of Taxation as in relation to EET Group's method of analysis. Also, for this reason, it cannot lead to a violation of the transfer pricing documentation that EET Group has not performed a segmentation that it is specifically impossible to perform.

The Ministry's final view in support of setting aside the transfer pricing documentation is that EET Group has not, in connection with its transfer pricing analysis, made a narrowing of the arm's length interval to only the interquartile range. However, it follows from established case law that even if the Ministry "raises legitimate doubts about the comparative analysis", this cannot in itself lead to a disregard of the transfer pricing documentation, see for example the Supreme Court's judgment in UfR 2020.3156H and the Eastern High Court's judgment in UfR 2022.4735. Therefore, the Ministry's view must be rejected. In addition, for the sake of completeness, the transfer pricing documentation contains statements of interquartile ranges, and there was no basis for using the interquartile range to make a narrowing of the arm's length range.

When the taxpayer has prepared proper transfer pricing documentation, as here, the tax authorities have a double burden of proof. Specifically, the Danish Ministry of Taxation must first prove that the pricing of the goods transactions between EET Group and the sales companies violated the arm's length principle, and then that the Danish Tax Agency's assessment is in accordance with the arm's length principle. The Danish Ministry of Taxation has not met any part of this burden of proof.

In the present case, the Danish Ministry of Taxation's evidence that there should have been a specific violation of the arm's length principle is based solely on the Danish Tax Agency's alternative assessment. However, an alternative assessment, such as the one made by the Danish Tax Agency in this case, can never constitute "its own legal basis". It cannot in itself prove that the Danish Tax Agency has acted in violation of the arm's length principle, see, for example, the Western High Court's judgment in SKM2020.397 and the Eastern High Court's judgment in UfR 2022.4735. This applies all the more when the alternative assessment is not aimed at identifying the full arm's length interval, but rather aims t o identify as narrow an interval as possible (resulting in significant increases in income).

Furthermore, the Danish Tax Agency's estimate is based on a fundamentally unsuitable method and an incorrect basis, which is why the estimate unsurprisingly leads to manifestly unreasonable results.

If the High Court nevertheless finds that there is a basis for making an assessment change, the starting point is that this assessment change must be based on the assessment of arm's length conditions made by the Danish National Tax Tribunal. The Danish National Tax Tribunal is thus the highest tax assessing authority in Denmark, and it follows from established practice that a (justified) assessment made by the Danish National Tax Tribunal can only be set aside by the courts if there is certain proof that the assessment must be changed, see for example UfR 2019.1446H, UfR 2020.3156H and SKM 2020.397V. The Danish Ministry of Taxation has not provided such certain proof that - if a discretionary assessment is justified - there is a basis for setting aside the Danish National Tax Tribunal's assessment and replacing it with the Danish Tax Agency's assessment.

The comparability analysis

EET Group claims that the comparability analysis under the transfer pricing rules must be made by comparing the gross margins of EET's sales companies and the independent benchmark companies, respectively, and not by comparing the net margins as decided by the Danish Tax Agency.

In concrete terms, it is most accurate to use a gross margin-based method to test the pricing of the intra-group sales of goods, because EET Group actually sets its prices according to a cost-plus method, which is also gross margin-based. The test method thereby comes as close as possible to the intra-group sales under review. TPG emphasizes that there is a preference for as high a degree of proximity to the transaction and as high a degree of comparability as possible. In this way, a number of the sources of error in net profit-based methods, such as the Danish Tax Agency's method, are avoided.

With the assistance of professional advisors, EET Group has conducted extensive database research using quantitative and qualitative screenings to find the most reliable, independent benchmark companies, all operating in the same industry as the EET Group. The gross margins of the benchmark companies have been calculated as accurately as possible based on the available data, and neither the Danish Tax Agency nor the Danish Ministry of Taxation has identified any more comparable benchmark companies or any more accurate way of calculating their gross margins. EET Group has also corrected the gross margins of the sales companies for extraneous factors on both the revenue and expense side to ensure that the gross margins are calculated as uniformly and accurately as possible. EET has also provided extensive material showing the reconciliation between the local financial statements, EET Group's internal consolidation accounts and transfer pricing documentation for the 2010, 2011 and 2012 financial years respectively.

When the taxpayer has made a justified arm's length analysis, it is incumbent on the tax authorities to use this method as a starting point. EET Group's choice of method can thus only be set aside if the Danish Ministry of Taxation demonstrates that the choice of method is unsuitable and that it cannot be adjusted for any comparability defects. The Danish Ministry of Taxation has not met this burden of proof.

It is stated in the Danish Tax Agency's decision as a deficiency in the transfer pricing documentation's comparability analysis that it does not distinguish "between different markets and industries" and that "each company's functions, assets and risks have not been considered independently". However, there is no need to distinguish between different industries because all EET's sales companies and all of the benchmark companies operate in the same industry.

The functions, assets, and risks of the EET sales companies and the benchmark companies are also comparable. EET's sales companies are thus the "front line" of the EET Group, and they build and develop the markets, set their own prices, are the only ones in contact with customers and control their own market management. As a result of these functions, the sales companies - like the marketing companies - bear the risk of realizing losses if they do not manage to generate a turnover that exceeds their costs. It is therefore wrong when the Danish Tax Agency and the Danish Ministry of Taxation focus one-sidedly on the sales companies' risks and do not consider the sales companies' essential functions.

As regards differences between country markets, EET Group has taken this into account in its interpretation of the results of the comparability analysis. For example, EET Group has taken into account that the [redacted] sales company sold many high-end products during the case period and therefore realized high gross margins. The Danish Tax Agency, on the other hand, has not taken this into account in its decision, but has read and determined the sales company's net margins at 2.5 percent. This is an error, and the OECD also describes in TPG 2010, section 3.4, that it is accepted good practice to conclude a comparability analysis by interpreting the collected data in the business context before determining the arm's length price.

The Danish Tax Agency has also stated that it is a shortcoming of EET Group's gross margin-based method that it does not "distinguish between different product categories." The explanation for this is that it has not been possible to find publicly available market data for comparable sales companies within the IT industry, which is divided into own brands and generic products. The available databases have only contained data for the independent sales companies' sales of their total product portfolio. However, by carefully selecting the benchmark companies, EET Group has, as far as possible, ensured that the benchmark companies are comparable with the sales companies.

EET Group's database studies thus represent the best possible basis of comparison that was available when the transfer pricing documentation was prepared in the respective income years. The companies' products therefore do not prevent an analysis at gross profit level.

EET Group also agrees with the Danish Tax Appeals Agency and the Danish National Tax Tribunal that "any differences in accounting standards between the sales companies and the comparable companies will have less impact on the arm's length interval, as the interval includes data from a significant number of companies, and therefore such adjustments will have less impact on the interval as a whole." EET Group also agrees with both the Danish Tax Appeals Agency and the Danish National Tax Tribunal that EET Group "has made calculations of gross profits that can be included with sufficient certainty in the comparability analysis." The Danish Ministry of Taxation's procedural requests do not change this.

The Danish National Tax Tribunal has similarly concluded that EET Group, when preparing the database searches, has sufficiently taken into account the exclusion of similar companies with booked intangible assets and the exclusion of companies with a certain storage capacity. EET Group has done this by selecting in each case the specific search criteria that gave the most reliable results. These limitations are confirmed by the fact that the Danish Tax Agency and the Danish Ministry of Taxation have at no point themselves searched for and pointed out alternative benchmark companies that are more comparable than those found by EET. The Danish Tax Agency and the Danish Ministry of Taxation have only stated that there are certain differences in the selection criteria for each of the income years but have not demonstrated any specific relevance thereof or pointed out better alternatives to the selected benchmark companies. Of course, this does not lift the Danish Ministry of Taxation's burden of proof.

The Danish National Tax Tribunal also found that EET Group's comparison of gross turnover was "rightly applied", even though the Danish National Tax Tribunal was explicitly aware that the Danish Tax Agency had based its decision on an assumption that there are large differences in the operating cost intensity of the comparable companies.

During the trial, the Danish Ministry of Taxation repeated the viewpoint under a different name. The Ministry of Taxation has thus argued that differences in the benchmark companies' capacity costs (referred to as "OPEX" by the Ministry of Taxation) constitute a source of error when comparing at gross profit level, but not when comparing at net profit level. EET Group has countered this view during the exchange of pleadings and demonstrated that capacity costs, as well as differences therein, distort the results of a comparability analysis at the net profit level because there is no direct correlation between capacity costs and the intra-group prices of goods, which is at the core of this transfer pricing case. EET Group has further demonstrated that

while a company's capacity costs may have a potential, indirect impact on gross profit, but will not always do so, a company's capacity costs will directly affect net profit. The reason for this is that capacity costs are included in net profit and thus affect it directly. Capacity costs, on the other hand, are not included in gross profit.

In addition, the relationship between a company's capacity costs and revenue can be affected by many factors, e.g., that companies have different sales volumes that are directly reflected in a higher net margin for the applicable company, but not directly reflected in a higher gross margin. This constitutes a source of error in a test at net margin level, which is reduced by a test at gross margin level, cf. TPG 2010, paragraph 2.70.

Second, it is disputed that differences in capacity costs "are a strong indication" of different functions among companies, as claimed by the Danish Ministry of Taxation. By way of illustration, the EET sales companies all purchased goods from the EET Group at the same prices and resold them to the sales companies' customers at prices set by them. However, the EET sales companies realized different financial results during the case period. While all sales companies realized positive and stable gross margins (ranging from approximately [redacted] percent), the sales companies realized very different net margins (ranging from approximately [redacted] percent to negative net margins).

It is a misunderstanding when the Danish Ministry of Taxation assumes that this is a strong indication that there may be different functions and/or multiple functions among the sales companies. The EET sales companies had precisely identical functions. Instead, the differences in the sales companies' key figures are due to a number of other factors, such as whether the company is a start-up or an established company with a high turnover volume and significant economies of scale, whether the sales company sells many high-end products, the competitive situation in the different countries' markets, and/or whether the sales companies have entered into advantageous agreements with independent parties or are otherwise better at selling products in their respective markets than other sales companies. It is factors such as these - and in particular, the issue of volume - which for the sales companies were decisive for some to achieve significantly higher net margins than others during the case period, even though the sales companies could buy products from EET Group at the same prices.

In summary, it can be stated that such costs can potentially affect the gross margin but will always have a direct impact on the net margin. As differences in capacity costs thus distort the results of the comparability analysis at the net margin level, this argues in favor of conducting the comparability analysis on the basis of gross margins rather than on the basis of net margins.

All database studies must be included in an overall analysis
It is a fundamental principle for all administrative decisions that they must be based on as accurate a basis as possible. In the same direction, it follows from the OECD's instructions in the TPG that taxpayers may submit subsequent material in order to support the taxpayers' transfer pricing analyses, see TPG 2010, section 3.61. Finally, the Supreme Court has consistently based its decisions on all the analyses available in the cases, including subsequent analyses prepared during the proceedings before the Supreme Court.

EET Group claims that all the transfer pricing analyses available in the case must be included, so that the sales companies must be tested against the benchmark companies from all five database studies in one overall test with inclusion of all market data presented in the case. Thus, there is no evidence that the transfer pricing documentation, which according to the Danish National Tax Tribunal was adequate individually, becomes less adequate by being used together. In addition, the transfer pricing analyses individually and together reach the same conclusion, namely that EET Group has acted on arm's length terms with the sales companies.

The interquartile range
Section 2 of the Danish Tax Assessment Act states that group companies etc. in their dealings must apply prices and terms in accordance with what could have been achieved if the transactions had been concluded between independent parties. Thus, the provision only requires that the prices and terms used by the group companies must be within the (often wide) range that could realistically have been agreed between independent parties under otherwise similar circumstances. The relevant yardstick under section 2 of the Danish Tax Assessment Act is thus the full arm's length range.

When, as in this case, the tax authorities argue for an almost exception-free application of the interquartile range, it is almost always with reference to TPG 2010, section 3.57. According to TPG, however, it is firstly a condition that there is a significant number of observations before it makes sense to consider the use of statistical tools. Secondly, the TPG refers to the interquartile range as an example among other possibilities. Thirdly, it is noted that even if there are a significant number of observations (with possible comparison defects), according to TPG, it is not a law of nature that it is relevant to use statistical methods in the attempt to identify the most correct (full) arm length interval.

Already when reading the TPG, it can thus be seen that the Danish Ministry of Taxation's uncritical use of the interquartile range is not supported by the TPG. It should also be noted that this reading of the TPG is also confirmed in case law, of which

it thus follows that the tax authorities cannot order taxpayers to use the interquartile range to halve the arm's length intervals identified by the taxpayers, see for example the judgments reproduced in SKM2020.397V, U2022.4735Ø and SKM2024.106B.

It follows from the TPG that in certain circumstances it "may" be useful to use statistical methods in order to counteract comparability deficiencies in a provided data basis, and the OECD mentions the interquartile range as an example of such a method. The prerequisite for using the interquartile range is thus that in the specific case there is a relevant statistical method that can specifically remedy comparability defects. The question is then whether, in the present case, there is statistical evidence to narrow the comparative data identified by EET to the interquartile range. According to two independent professors of statistics, the answer to that question is "no".

The statement from Professor Mogens Steffensen presented to the High Court shows, firstly, that there may be several sources for the spread between the results in a data set, including the fact that completely similar traders may earn different margins. Therefore, the fact that there is dispersion between the results does not provide a basis for statistically concluding that there are comparability defects. Secondly, it is pointed out that a narrowing to the interquartile range, whereby 50% of the results are excluded, is highly unconventional from a statistical assessment. A common statistical, professional starting point is to use a so-called significance level o f 5 percent. The uncritical use of the interquartile range claimed by the Danish Ministry of Taxation therefore entails a high risk of incorrect results. Thirdly, it is pointed out that statistical methods should only be used when the comparison portfolio is sufficiently large, which generally requires at least 10 observations. Also, for this reason, the views of the Danish Ministry of Taxation must be rejected.

The statement from Professor Mogens Steffensen thus clearly documents that the uncritical use of the interquartile range claimed by the Danish Ministry of Taxation is unfounded and often contrary to general statistical methodology and thus also contrary to TPG 2010, section 3.57. This means that the Danish Ministry of Taxation must be able to prove the specific relevance of using the interquartile range in the present case. The starting point is that it cannot be arbitrarily imposed on taxpayers to eliminate 50 percent of the arm's length interval.

During the preparation of the case before the Eastern High Court, an expert appraisal was also obtained from Professor of Statistics, Søren Feodor Nielsen, who confirms that the Danish Ministry of Taxation's uncritical use of the interquartile range must be rejected, including as contrary to statistical methodology. Firstly, the statement states that there is a statistical professional preference for such a large data basis as

possible. It follows that you have to be very careful not to discard data that you are not sure is unsuitable. This in itself speaks against the use of the interquartile range. Secondly, it is not possible to use the interquartile range or other statistical principles to counter suspected unidentified comparability defects. Third, the interquartile range is too small a range if what we are interested in is the entire data range.
It also follows from the discretionary statement that the Danish Ministry of Taxation's wish for an uncritical use of the interquartile range must be rejected. It is quite simply "too small an interval".

During the preparation of the case, the Danish Ministry of Taxation has repeatedly made considerable efforts to try to show that if the full range is applied, EET Group or the sales companies could achieve extremely high or extremely low earnings if all sales companies were at one or the other end of the full range. The Danish Ministry of Taxation's argumentation is irrelevant to the case.

EET Group thus submits that the actual gross margins of the sales companies are at arm's length and that this is evidenced by the fact that the gross margins are within the arm's length range of independent, comparable benchmark companies. These actual gross margins vary from company to company but are generally at the high end of the range. This is partly due to the fact that most of the sales companies sold [redacted] during the case period.

The use of the full interval range does not mean that the gross margins of the sales companies can or should automatically be adjusted up to correspond to the maximum of the interval (or any other specific point in the interval for that matter). It would thus obviously be contrary to the arm's length principle if a large group of companies all achieved completely the same earnings, regardless of whether this is calculated at gross or net level.

The arm's length interval is just that - an interval, which is also seen in the comparison companies that EET Group has identified. The earnings levels achieved by the sales companies reflect this interval, which is also true at both gross and net level. This fact further supports the fact that the intra-group trade was conducted on arm's length terms. The High Court can therefore disregard the Ministry's remarks about extreme results based on fictitious gross margins.

Finally, there is reason to note that if the use of the interquartile range is accepted specifically or in other cases, the Danish Tax Agency (and the Danish National Tax Tribunal) has in this case - as is generally the case - without further justification chosen to calculate the interquartile range using the so-called "QUARTILE.INC function".

In this or any other case, the tax authorities have not provided a professional justification that demonstrates why the QUARTILE.INC function is more appropriate to use than some of the other methods used in practice for quartile calculations. The real justification seems to be that the QUARTILE.INC function is used because it is "the way we do things".

However, the method used by the tax authorities always leads to the most burdensome result for the taxpayer, namely the narrowest possible interval. Therefore, if the High Court were to find the use of the interquartile range to be justified, it is in any event incumbent on the Danish Ministry of Taxation to prove with certainty that the use of the most burdensome method for EET Group to calculate the range is justified.

The median
The Danish Tax Agency's decision is based on the assumption that if the sales companies in the EET Group in one or more income years have had net earnings (EBIT margin) outside the interquartile range calculated by the Danish Tax Agency, a tax assessment change must be made so that the sales companies are treated for tax purposes as if their net earnings corresponded to the median, i.e. the midpoint, of the narrowed interval, which the Danish Tax Agency considered the arm's length interval.

The Danish National Tax Tribunal found that for certain of the sales companies in the EET Group there was a basis for making a change of assessment. In relation to the sales companies in relation to which the Danish National Tax Tribunal found that a change of assessment was necessary, the Danish National Tax Tribunal made a specific assessment in order to determine how the changes of assessment should be made. In view of the specific circumstances of the case, the Danish National Tax Tribunal thus estimated that the assessment changes - to the extent there was a basis for such - should be made to the nearest point in the arm's length interval estimated by the Danish National Tax Tribunal, specifically to the third quartile.

In doing so, the Danish National Tax Tribunal made a completely customary official assessment based on the specific circumstances. If the Eastern High Court agrees with the Danish National Tax Tribunal that there is a basis for making changes to the assessment, it follows from the general principles of administrative law that the Danish Ministry of Taxation bears a strict burden of proof if the Danish National Tax Tribunal's exercise of discretion is to be set aside. The Danish Ministry of Taxation has not met this burden of proof.

During the preparation of the case before the courts, the Danish Ministry of Taxation defended the point of view of an adjustment to the median with particular reference to TPG 2010, pt.
3.62. In exactly the same way as is the case in relation to the Danish Ministry of Taxation's

alleged use of the interquartile range, however, there is no basis in the TPG for any adjustments to be automatically made to the median.

The OECD uses the terms "may" and "depending on the specific characteristics of the data set" in the TPG, and the OECD assumes that the use of the median (or other methods) is only relevant if comparability gaps remain. Nothing herein supports an automatic adjustment to the median, let alone that an adjustment to the nearest point would be wrong. Thus, the instructions in the TPG do not support the Danish Ministry of Taxation's view. In addition, in another case, the Danish Ministry of Taxation itself has previously argued and won that an adjustment based on a specific estimate should be made to the 3rd quartile. Thus, there is also support in case law that the Danish National Tax Tribunal's discretion lies within the margin of discretion that - if an adjustment is justified - belongs to the tax authorities, here the Danish National Tax Tribunal.

Finally, it should be noted that Professor Mogens Steffensen in his statement also addressed the Danish Tax Agency's and the Danish Ministry of Taxation's view on an adjustment to the median. The statement states that the correction itself can hardly be said to be based on a statistical method. It is moving a data point and outside the scope of statistical methodology.

Therefore, it must be noted that there is no statistical basis for the Danish Ministry of Taxation's wish to override the Danish National Tax Tribunal's estimate and make an adjustment to the median. It should also be noted - as pointed out by Professor Jens Wittendorff - that the administrative law principle of proportionality dictates that any correction must be made to the nearest point in the interval, as a correction to another point would be punitive in nature and would lead to arbitrary results.

The Eastern High Court's reasoning and result

The case concerns the assessment of EET Group A/S' taxable income for the income years 2010-2012. By decision of July 8, 2016, the Danish Tax Agency made a discretionary assessment of EET Group's taxable income for 2010-2012 and increased the income by a total of DKK 128,810,000. The increase was made with reference to the fact that EET Group had not acted at arm's length, see section 2 of the Danish Tax Assessment Act. By decision of October 28, 2020, the Danish National Tax Tribunal reduced the increases to DKK 29,587,135.

The parties agree that these are controlled transactions covered by section 2 of the Danish Tax Assessment Act and that EET Group in the transactions has had to act in accordance with what could have been achieved if the transactions had been concluded between independent parties (the arm's length principle).

The question is whether EET Group has observed the arm's length principle, including whether the prepared transfer pricing documentation regarding the EET sales companies is so deficient that the tax authorities have been entitled to increase EET Group's taxable income in the tax years 2010-2012 at their discretion, and if so, whether there are grounds to set aside the discretion exercised by the tax authorities.

Transfer pricing documentation
It appears from the current provisions in section 3 B (8) of the Danish Tax Control Act, see section 5(3), that if the taxpayer has not prepared the statutory documentation for pricing (transfer pricing documentation), the tax assessment can be made discretionarily. In its judgment of April 26, 2021 (UfR 2021.3179), the Supreme Court has ruled that transfer pricing documentation that is so significantly deficient that it does not provide the tax authorities with a sufficient basis for assessing whether the arm's length principle has been complied with must be equated with missing documentation.

It is undisputed in the case that EET Group has prepared transfer pricing documentation that was available when the tax authorities made their decision on July 8, 2016. The question is therefore whether the transfer pricing documentation is so deficient that it must be equated with missing documentation.

Based on the evidence, including the explanation from Jan Holmetoft Iversen, the High Court assumes that the pricing between EET Group and the sales companies was based on a cost-plus method and that this method is customary within the industry. It is also assumed as undisputed that the transfer pricing documentation fulfills the formal requirements in sections 4-8 of the TP Order, including that the documentation includes a comparability analysis.

The High Court also finds that the transfer pricing documentation does not contain a segmentation of each sales company's earnings from the purchase and resale of goods purchased by EET Group and goods purchased from external suppliers, respectively, and that revenue from non-controlled transactions (external purchase of goods) is thus included in the assessment of whether the controlled transactions (internal purchase of goods) are made on arm's length terms. It is furthermore assumed that EET Group in the benchmark analysis for 2010 and 2011 has compared with companies that have an inventory of between 5 and 25 percent of turnover and intangible assets of up to 5 percent of turnover, even though most of the EET Group's sales companies have no inventory, and even though none of the sales companies have booked intangible assets.

After an overall assessment of the above, the High Court finds that the transfer pricing documentation was not deficient to such an extent that it can be equated with lack of documentation. In this regard, the High Court has, among other

things, emphasized that the fact that the tax authorities disagree with or raise justified doubts about the comparability analysis, or the choice of transfer pricing method does not in itself mean that the documentation is significantly deficient. The High Court has also attached importance to the fact that the transfer pricing documentation has not been useless to the tax authorities, as the tax authorities have made a decision based on the information contained in EET Group's transfer pricing documentation, including the prepared comparability analysis. Nor does the High Court find that the other alleged deficiencies, including the differences in accounting standards between the sales companies and the comparable companies, can lead to a different assessment.

The High Court therefore finds that EET Group's income could not be assessed on a discretionary basis pursuant to section 3 B (8), see section 5(3), of the current Danish Tax Control Act.

The assessment of arm's length terms

The question is then whether the Danish Ministry of Taxation has demonstrated that EET Group's transactions with the sales companies were not at arm's length.

In support of this, the Danish Ministry of Taxation has in particular stated that the EET Group has used a transfer pricing method which is not one of the five methods recognized in the OECD Transfer Pricing Guidelines. The Danish Ministry of Taxation has furthermore stated that EET Group has not acted on arm's length terms when the sales companies' earnings fall outside the interquartile range.

For the reasons stated by the Danish National Tax Tribunal, the High Court agrees that EET Group in its transfer pricing documentation has rightly used a comparison of the sales companies' gross margins in relation to the comparable companies selected by the company as the basis for the arm's length analysis. The High Court has also attached importance to the fact that the company sets its prices according to a cost plus method, which is based on gross profit, and that the company's gross profit-based test method therefore ensures a higher degree of proximity to the transactions than the TNM method used by the tax authorities, which is based on net profit, see Transfer Pricing Guidelines 2010, section 2.10. The fact that EET Group itself states in the transfer pricing documentation that a comparison is made according to the TNM method cannot lead to a different assessment. Even if the reference to the TNM method cannot be considered correct, the actual method used is thus stated in the transfer pricing documentation.

As regards the applied arm's length intervals, the High Court finds, after an overall assessment, no basis for setting aside the Danish National Tax Tribunal's assessment that the intervals in this case cannot constitute the full intervals for the comparable companies' key figures, but must be narrowed down to the interquartile ranges, see Transfer Pricing Guidelines 2010, paragraph 3.57. The High Court has in particular

emphasized that there are certain comparability defects in the prepared database studies, e.g. because in 2010 and 2011 comparisons were made with companies with inventories of between 5 and 25% of turnover and intangible assets of up to 5% of turnover, even though most of the sales companies do not have inventories and even though none of the sales companies have booked intangible assets. The High Court also emphasized that in 2012, without further explanation, the selection criteria were changed, and that this meant that none of the companies that were comparable in 2010 and 2011 were comparable in 2012. Under these circumstances, the information provided by EET Group, including the statement from Professor Mogens Steffensen and expert appraiser Søren Feodor Nielsen, cannot lead to a different result.

Finally, the High Court finds no basis to set aside the Danish National Tax Tribunal's assessment according to which the income for the sales companies whose gross profit lies outside the interquartile ranges for the individual income years 2010, 2011 and 2012 must be adjusted to the closest point in the arm's length interval, i.e. to the third quartile. What the Danish Ministry of Taxation has argued before the High Court regarding this element of the Danish National Tax Tribunal's decision cannot lead to a different result.

Accordingly, and as the High Court also finds no other basis for setting aside the discretionary assessment of the income by the Danish National Tax Tribunal, the High Court accepts that the income assessment for the income years in question is as determined by the Danish National Tax Tribunal.

Conclusion and legal costs

The High Court then upholds EET Group's main claims 1 and 2 for acquittal, and the Danish Ministry of Taxation is acquitted of EET Group's main claim 3 and EET Group's subsidiary claim.

Following the outcome of the case in relation to the claims made by the parties, the Danish Ministry of Taxation must pay DKK 630,500 in partial legal costs to EET Group. Of this amount, DKK 30,500 is to cover the cost of the expert appraisal of January 14, 2023, and the hearing of the expert appraiser and DKK 600,000 is to cover the cost of legal counsel. It is stated that EET Group is registered for VAT. In addition to the value of the case, the amount for the legal counsel has been determined taking into account the scope and course of the case, including that the case has been heard over five court days.

For these reasons:

EET Group A/S is acquitted, and the Danish Ministry of Taxation is acquitted of EET Group A/S' claim 3 and subsidiary claim.

The Danish Ministry of Taxation must pay DKK 630,500 in legal costs to EET Group A/S within 14 days. The amount is subject to interest according to section 8a of the Interest Act.