Italy

The Transfer Pricing Implications of "Business Restructurings" from the Perspective of the Italian Tax Police

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This article discusses the approach (to be) adopted by the Italian tax police in relation to the transfer pricing implications of business restructurings, as disclosed under their Circular Letter No. 1/2018, also in light of the relevant and most recent OECD Guidelines. The article includes some additional remarks as well as working examples to expand on the viewpoint of the tax police regarding cross-border restructurings.

1. Circular Letter No. 1/2018 Issued by the Italian Tax Police

In 2018, the Italian tax police (*Comando Generale della Guardia di Finanza, III Reparto Operazioni – Ufficio Tutela Entrate*) published the updated version of its operating manual for tackling tax evasion and tax fraud, the *Manuale operativo in materia di contrasto all'evasione e alle frodi fiscali*, otherwise referred to as Circular Letter No. 1/2018 (hereinafter the "Circular Letter").[1]

The aim of the Circular Letter is to provide tax police inspectors[2] with some updated guidelines and a general overview of the main issues they should consider when carrying out a tax audit. Notwithstanding the wide range of subjects treated within the document, the present article will focus on the chapter dedicated to transfer pricing issues,[3] especially with regard to the topic of business restructuring.

The Circular Letter provides a general introduction to the main relevant features of transfer pricing legislation (i) describing the domestic provision of article 110(7) of Presidential Decree No. 917 of 22 December 1986 and some of its practical implications, and (ii) summarizing the more pertinent instructions provided in the OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017) (hereinafter the "OECD Guidelines"),[4] including an illustration of the various transfer pricing methodologies.

In connection with the above, it may be interesting to outline some of the matters treated in the Circular Letter. As a general comment, one may first of all notice that the tax police appear to take an innovative and comprehensive position on the various transfer pricing issues by adopting, on several occasions, an approach that shows a willingness to perform tax audits that rely on case-by-case evaluations, as opposed to merely highlighting tax elusive or abusive schemes to be purposely challenged.

In this respect, one may appreciate that the Circular Letter emphasizes that the pre-condition for the application of transfer pricing legislation is that "the enterprise of a group to which the higher profits are attributed benefits from a more favourable fiscal treatment in the foreign jurisdiction than the one applicable to the original owner of the income".[5]

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1. Italian tax police, *Circolare 1/2018 – Manuale operativo in materia di contrasto all'evasione e alle frodi fiscali*, 2018 (Circular Letter No. 1/2018) [hereinafter Circular Letter 2018].
2. Tax audits in Italy may be performed both by the Revenue Agency (*Agenzia delle Entrate*), which is also the authority responsible for issuing the tax assessment notice (*Avviso di Accertamento*), and the tax police (*Guardia di Finanza*).
   The tax police, supervised by the Minister of Economy and Finance, is a military body that specializes in combating tax fraud, smuggling and tax crimes. On behalf of the Revenue Agency, it carries out tax audits, which are then documented (as is also the case for tax audits carried out directly by the Revenue Agency itself) in the tax audit report (*Processo Verbale di Constatazione*, PVC). The various claims that may be raised in the tax audit report are then subject to review by the competent provincial directorate or regional directorate, which will ultimately issue the aforementioned tax assessment notice.
   Territorially, the tax police is organized into three levels. At the top, there are inter-regional chiefs (*Comando Interregionale*) located in Florence, Milan, Naples, Palermo, Rome and Venice. Each one coordinates and has authority over the regional chiefs (*Comando Regionale*) who operate within the inter-regional chief's jurisdiction. At the second level, regional chiefs are located in every regional seat (*Capoluogo di Regione*). The regional chief has planning and organizational responsibilities in order to better coordinate the activities of the provincial chiefs (*Comando Provinciale*). In turn, regional chiefs coordinate the third level, namely the provincial chiefs, who are located in every provincial capital (*Capoluogo di Provincia*) except for the district of Aosta. The provincial chiefs carry out all operational activities and oversee two offices, the *Comando* and *Operazioni*, which are, in turn, organized into further sections.
3. *See* para. 4(c), ch. 11, part V, vol. III Circular Letter 2018.
4. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2017), International Organizations' Documentation IBFD [hereinafter *OECD Guidelines*].
5. *See* para. 4(c)(1), ch. 11, part V, vol. III Circular Letter 2018.

In substance, this means that, according to the Circular Letter, the Italian transfer pricing legislation should essentially be applicable if a "more favourable fiscal treatment" abroad is ascertained. In such a way, the tax police seem to distance themselves from certain Italian jurisprudence according to which the above-quoted article 110(7) shall indeed be applied every time a transaction with a foreign related party is not at arm's length, irrespective of the burden of taxation abroad.[6]

It should also be observed that the Circular Letter places considerable emphasis on the changes to the OECD Guidelines brought about by BEPS Actions 8-10.[7] More precisely, the Italian tax police underline that, after the amendments introduced by the OECD BEPS Project, primary importance has to be granted, when evaluating the arm's length condition, to the contractual conditions in place between the associated parties. In this respect, it is clarified that "the contractual conditions formally agreed by the parties always have to be considered as the starting point for an audit, although they need to be carefully examined in order to verify if and to which extent they reflect the substantial reality, taking on the necessary amendments when the substantial reality is not adequately represented".[8]

As mentioned, the tax police also provide a general overview of the transfer pricing methodologies, summarizing the various traditional and transactional OECD methods. However, with reference to the latter, namely to the profit split method, the Circular Letter maintains that it "is realistically applicable especially when the controlling entity is resident for tax purposes in Italy and, therefore, it is able to adequately implement internal procedures aimed at the profit allocation between the different entities belonging to the group, based on their actual participation in the production cycle".[9] Even though the description of the profit split method provided in the Circular Letter is relatively in line with the OECD Guidelines, the above-quoted statement appears to be quite deceptive since there is no restriction under the OECD Guidelines or any other practice (including that provided by the Italian Revenue Agency (*Agenzia delle Entrate*)) to limit the application of the profit split method (as it seems is the case in the Circular Letter that assumes the Italian residence of the controlling entity to be a sort of pre-condition for the reliable adoption of the method).

With reference to the traditional methods, and in particular to the comparable uncontrolled price (CUP) method, it is worth noting that the Italian tax police assume an interpretation in line with the main Italian jurisprudence[10] and doctrine[11] that consider this method as applicable only in residual situations that allow the enterprise to carry out a straight comparison with other products or services. One can indeed read in the Circular Letter that "the CUP method is theoretically the most valid [method] for the purposes of finding the arm's length price, but it presents effective and real practical limitations that render the method applicable with respect to raw materials and interchangeable goods".[12]

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6. In this respect, *see* decision IT: *Corte di Cassazione*, 19 Apr. 2018, 9673, according to which the Italian transfer pricing legislation does not represent an anti-avoidance rule ex se but it is aimed at annulling the economic phenomenon of the shifting of the taxable income upon the intercompany transaction not because of the concrete fiscal advantage obtained by the taxpayer but every time they are carried out at a price lower than the arm's length one. In this respect, *see also* decision IT: *Corte di Cassazione*, 15 Apr. 2016, 7493; IT: *Corte di Cassazione*, 30 June 2016, 13387; and IT: *Corte di Cassazione*, 15 Nov. 2017, 27018.
7. *See* OECD/G20, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Report*, paras. 1.42, 1.43 and 1.45 (OECD 2015), International Organizations' Documentation IBFD:

   > Where a transaction has been formalised by the associated enterprises through written contractual agreements, those agreements provide the starting point for delineating the transaction between them and how the responsibilities risks, and anticipated outcomes arising from their interaction were intended to be divided at the time of entering into the contract. The terms of a transaction may also be found in communications between the parties other than a written contract. However, the written contracts alone are unlikely to provide all the information necessary to perform a transfer pricing analysis, or to provide information regarding the relevant contractual terms in sufficient detail. Further information will be required by taking into consideration evidence of the commercial or financial relations provided by the economically relevant characteristics in the other four categories … : the functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, together with the characteristics of property transferred or services provided, the economic circumstances of the parties and of the market in which the parties operate, and the business strategies pursued by the parties. Taken together, the analysis of economically relevant characteristics in all five categories provides evidence of the actual conduct of the associated enterprises … . If the characteristics of the transaction that are economically relevant are inconsistent with the written contract between the associated enterprises, the actual transaction should generally be delineated for purposes of the transfer pricing analysis in accordance with the characteristics of the transaction reflected in the conduct of the parties.

8. *See* para. 4(c)(2)(a), ch. 11, part V, vol. III Circular Letter 2018.
9. *See* para. 4(c)(2)(a), ch. 11, part V, vol. III Circular Letter 2018.
10. *See*, *inter alia*, IT: *Commissione Tributaria Regionale del Piemonte*, 14 Apr. 2010, 25/34/10: "the jurisprudence clearly imposed the abandonment of the CUP in the absence of elements that allow a linear application of the same method".
11. *See* G. Maisto, *Il progetto di rapport OCSE sui prezzi di trasferimento*, Rivista di Diritto Tributario 1995, I, p. 383: "over fifteen years of application of the criteria elaborated by the OECD report of 1979 have shown that the comparison – the research of a transaction identical to the one under verification concluded between independent parties – presents difficulties often insurmountable that led sometimes to propose the substantial abandonment of the CUP method for the purposes of determining the arm's length price". Furthermore, the same author noted that "the CUP method is a primitive historical wreck made obsolete by the expansion of multinational enterprises".
12. *See* para. 4(c)(2)(c), ch. 11, part V, vol. III Circular Letter 2018.

2. Business Restructuring under Chapter IX of the OECD Transfer Pricing Guidelines (In Brief)

Before entering into detail on the main focus of the present article (i.e. on the contents of the Circular Letter with specific reference to business restructurings), it is opportune to provide a brief and general outline of the most relevant instructions on the topic as reported in the OECD Guidelines.

In particular, Chapter IX of the OECD Guidelines focuses on the importance of performing a thorough analysis of the relevant context and background of the business restructuring, both at the time of the restructuring (under paragraph I) and after the restructuring has been completed (under paragraph II).[13]

In summary, business restructuring is defined as "the cross-border reorganization of the commercial or financial relations between associated enterprises, including the termination or substantial renegotiation of existing arrangements".[14] In order for a transaction to qualify as a business restructuring, it is essential to have a relocation of functions, risks, assets and/or the so-called "profit potentials".[15]

Throughout the OECD Guidelines, the main driver when performing a correct transfer pricing assessment is represented by the arm's length principle, to be applied considering the peculiarities of the restructuring in question. In fact, it is clearly stated that "the arm's length principle … does not and should not apply differently to restructuring or post restructuring transactions than to transactions that were structured as such from the beginning".[16]

The following stage should then establish if compensation is to be attributed in connection with the restructuring and to whom such remuneration must be paid.[17] To this end, it is essential to obtain a clear picture of the relevant context by (i) properly understanding the restructuring itself, (ii) accurately recognizing the transaction underlying the business restructuring and, as a final result, (iii) duly identifying the transfer of profit potentials.

The first step – according to the OECD Guidelines – includes performing a proper comparability analysis that must be carried out in order "to determine which party assumes specific risks before the restructuring and which party assumes specific risks following the restructuring".[18] Once the analysis of the risks has been completed, it becomes important to verify whether such risks carry with them a relevant profit.[19]

Besides the transfer of risks, a business reorganization could also be driven by the pursuit of synergies. The nature of the synergies has to be taken into account in order to understand whether and to what extent they generate an incremental profit potential.[20]

Another fundamental aspect of the comparability analysis for the purposes of a business restructuring concerns identifying the "options realistically available to the parties".[21] Such an investigation is necessary to verify whether other options were available to the group in order to achieve the same restructuring purpose based on the assumption that "independent enterprises would only enter into transactions if it does not make them worse off than their next best option".[22]

It is worth noting that the OECD clearly states that the competent tax authority does not have the power to (re)characterize a business restructuring except under exceptional circumstances. Furthermore, the fact that the restructuring is driven by a tax reason does not mean per se that the overall outcome is not in line with the transfer pricing legislation whereby each entity involved is properly remunerated.

To summarize, according to the OECD, in order to establish whether a remuneration is to be attributed within the context of a business restructuring, it is essential to carry out the aforementioned analysis and ascertain whether potential profit has been transferred. In essence, remuneration is due if independent parties would not have accepted such a reorganization without it.

Finally, part II of chapter IX of the OECD Guidelines focuses on the remuneration of post-restructuring controlled transactions. Indeed, "the comparability analysis of an arrangement that results from a business restructuring might reveal some factual differences compared to the one of an arrangement that was structured as such from the beginning"[23] and consequently give rise to some difficulties in correctly pursuing the application of the arm's length principle to post-restructuring arrangements.

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13. Chapter IX of the *OECD Guidelines* includes the outcome of the quite recent OECD Report on Transfer Pricing Aspects of Business Restructurings, released in July 2010. *See OECD Guidelines*, *supra* n. 4, at ch. IX, and OECD, *Report on Transfer Pricing Aspects of Business Restructurings* (OECD 2010).
14. *OECD Guidelines*, *supra* n. 4, at para. 9.1.
15. In particular, according to the Glossary of the *OECD Guidelines* (*supra* n. 4), the reference to "Profit Potential" is "often used for valuation purposes, in the determination of an arm's length compensation for a transfer of intangibles or of a going concern, or in the determination of an arm's length indemnification for the termination or … renegotiation of existing arrangements".
16. *OECD Guidelines*, *supra* n. 4, at para. 9.9.
17. Id., at para. 9.1-50.
18. Id., at para. 9.20.
19. Id., at para. 9.22.
20. Id., at para. 9.26: "for instance if the restructuring is needed to maintain competitiveness rather than to increase it. In addition, expected synergies do not always materialise – there can be cases where the implementation of a global business model designed to derive more group synergies in fact leads to additional costs and less efficiency".
21. Id., at para. 9.27.
22. Id., at para. 9.27.
23. *OECD Guidelines*, *supra* n. 4, at para. 9.101.

In this respect, the OECD Guidelines provide that any previous arrangements existing between the associated parties affected by the restructuring must also be considered, as they may influence the options available in negotiating the conditions of post-restructuring arrangements by rendering such conditions incomparable with those of arrangements arising out of a newly set up operation.

3. The Main Features of the Circular Letter on Business Restructurings

As mentioned, the Circular Letter contains several considerations on the topic of transfer pricing, especially with regard to business restructurings. These considerations will be described in depth in this section in order to outline the position that the tax police have assumed on this particular subject.

First of all, it should be noted that the tax police, in general terms, make reference to the OECD instructions on the topic, broadly quoting chapter IX of the OECD Guidelines.[24] In addition, they also provide operating guidelines to be followed by the inspectors when carrying out a tax audit. To this end, the Circular Letter encourages tax police inspectors to particularly focus on those business restructurings that follow the purchase of Italian companies by foreign investors, especially – as one can read in the document itself – when the Italian target is indeed a family-run business.

In this respect, it is indeed reported that in the experience of the Italian tax police, the purchase of Italian companies by foreign investors is one of those situations in which the "profit shifting" phenomenon appears more likely under the alleged assumption that once the local enterprise becomes part of a broader multinational group, "the foreign investor would have more chances to exploit low tax jurisdictions in which they could relocate a consistent portion of the (former) Italian business".[25]

This is in the alleged assumption that "business restructurings – especially in the absence of sound business reasons – may be the venue to pursue a tax advantage, if the relocation of profits is not in line with the arm's length standards".[26] It is, however, obviously stated that "the achievement of a tax saving is not, per se, challengeable when in line with the relevant tax legislation".[27]

In essence, according to the Circular Letter, in the context of the business restructuring, the criterion which should drive the activity of the Italian tax police during the inspection should always be aimed at pursuing the arm's length conditions. Due to this fact, as also stated in the document, the Italian tax police do not have the right to disregard the restructuring itself.

From this perspective, the Circular Letter does, therefore, emphasize how important it is that the comparability analysis be thoroughly performed during a tax inspection. It also emphasizes that this analysis is of twofold importance. First of all, it is fundamental in order to ascertain whether the business restructuring relies on sound economic reasons and not only a formal pattern. Secondly, the comparability analysis is the tool used to verify whether the restructuring should have given rise to a remuneration under fair market conditions.

The Circular Letter also correctly specifies that, in the context of a business restructuring, entities that have suffered a reduction/relocation of assets, functions or risks should, in principle, be remunerated, although no remuneration should be attributed if "at the time of the restructuring the relevant entity does not own rights or assets. On the contrary, the existence of significant assets should be a hint of a 'potential profit' to be compensated".[28]

In summary, according to the Circular Letter, the key question is: should the transfer of functions, risks and assets have given rise to a remuneration among third parties in comparable circumstances?

The Circular Letter goes on to recall some of the main features of a business restructuring that should be paid particular attention to during tax inspections, such as those regarding (i) companies in a loss-making position, (ii) companies that decide to delocalize part of their activities, and (iii) companies that decide to transfer intangible assets.

With reference to point (i), it is specified that, first and foremost, it should be verified whether the decision for a loss-making company to remain "in the market" is of advantage to the "group"; provided that if this is the case, a proper remuneration should indeed be acknowledged. However, it is also legitimately stated that if the business restructuring is merely aimed at reducing future expected losses, no remuneration should (of course) be acknowledged. In practice, according to the Circular Letter, the key aspect is "establishing if at arm's length conditions the loss making entity would receive a remuneration from a third party which could in turn receive a certain degree of benefit".[29]

In relation to point (ii), it is stated that when evaluating the option to delocalize and therefore de facto relocate the profits among the entities of the "group", "the relevant costs should also be considered (such as the costs for the closure of the original plant, the costs for the infrastructure which may be needed in the host jurisdiction, the possible higher transportation expenses, the training of the personnel, etc.)."[30]

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24. This full acknowledgement of the *OECD Guidelines* by the Italian tax police means, therefore, that the principles stated therein will be applied during inspections that will be carried out into this specific topic.
25. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.
26. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.
27. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.
28. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.
29. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.
30. In relation to this point, it is worth noting that Chapter IX of the *OECD Guidelines* states whether the "delocalization costs" have to be borne by the transferee (or by the transferor) should also be verified, given that it is also stated therein that such a compensation is not due if the expected savings are higher than the same "delocalization costs". *See OECD Guidelines*, *supra* n. 4, at para. 9.74.

With regard to point (iii), the Circular Letter emphasizes the fact that the transfer of intangibles “often hides aggressive tax planning schemes”[31] and that the factors to be considered in ascertaining whether the transfer of the relevant intellectual property (IP) is at arm’s length are:

- the amount, duration and riskiness of the expected profits deriving from the exploitation of the intangible;
- the nature of the intangible and the applicable restrictions; and
- the main features of the legal protection granted to it.

Within this context, the tax police appear to be quite interested in rigorously scrutinizing those restructurings that imply a substantial “sale and lease-back” of the intangible assets. In these circumstances, “a thorough analysis will have to be carried out in order to verify whether the change of the legal title of the IP (e.g. from owner to licensee) has been made for valid economic reasons or only with the scope of benefitting from an undue tax advantage”.[32]

To conclude, the efforts made by the tax police to provide detailed instructions to its tax inspectors undoubtedly have to be praised since they fill a previous gap which probably gave rise to some uncertainty during tax audits.

To this end, the Circular Letter invites the inspectors to carefully perform a functional analysis, encouraging them to ponder the outcome of the cited functional analysis, which has to be performed before and after the restructuring. Unfortunately, however, the Circular Letter misses the opportunity to provide some detailed examples and release definitive instructions to be followed during the more operative stages of the audit.

4. A Working Example to Expand on the Tax Police’s Thoughts

The authors would like to propose the following example to expand on some of the profiles outlined in the Circular Letter and especially shed some light on certain practical implications that may characterize business restructurings for which no compensation is due to the restructured entity.

In this example, it is assumed that ALPHA carries out a cross-border going concern transfer to its subsidiary BETA. The aforementioned going concern (hereinafter the “Going Concern”) manufactures semi-finished products that are utilized by ALPHA for further manufacturing and the creation of the final product.

Due to the significant personnel costs borne by ALPHA in its country of residence and to the massive investments in machinery, the Going Concern profit and loss statement (P&L) consistently reports losses.

ALPHA, therefore, considers delocalizing the Going Concern to a foreign “low labour-cost” country in order to report a certain degree of profitability. To this end, ALPHA intends to carry out the transfer via an asset deal to BETA.

Within this context, the arm’s length conditions should be verified as follows:

- Firstly, a thorough analysis of the relevant functions, risks and assets of the Going Concern should be performed.
- Secondly, the sale price should be determined according to commonly accepted valuation techniques.
- Thirdly, an analysis of the relevant functions, risks and assets of ALPHA after the restructuring should be carried out in order to establish if and how the relevant rights and obligations of the former owner of the Going Concern (i.e. ALPHA) have been modified upon the transfer.

This will be outlined in further detail in the tables contained in sections 4.1.-4.2.3.

4.1. Analysis of the functions carried out, the risks assumed and the assets that constitute the Going Concern

The Going Concern is active in Italy in manufacturing a semi-finished product that is used by ALPHA for the creation of the final product, according to the following tables:

Table 1

Functions	**ALPHA**	**Going Concern**
Purchase of raw materials		X
Production		X
Quality control		X

31. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.
32. *See* para. 4(c)(4), ch. 11, part V, vol. III Circular Letter 2018.

Functions	ALPHA	Going Concern
Sales	X	
General services		X

Table 2

Risks	ALPHA	Going Concern
Market risk	X	
Warehouse risk		X
Credit risk	X	
Foreign exchange risk		

Table 3

Assets	ALPHA	Going Concern
Plant and machinery		X
Industrial equipment		X

4.2. Estimate of the sale price of the Going Concern

For the estimate of the sale price of the Going Concern, the following figures should also be considered.

4.2.1. The income statements and balance sheets of the Going Concern

The going concern in question realized the following negative results in the period 2014-2016:

Table 4

	2014	2015	2016
Revenues	100	110	95
Expenses	108	120	108
Operating income	-8	-10	-13

The balance sheet as at 31 December 2016 is shown in the table below:[33]

Table 5

	2016
Inventories	40
Receivables from customers	30
Plant and machinery	50
Accounts payable	(20)
Other payables	(10)
Net assets	**90**

4.2.2. The price estimation

ALPHA, by transferring the Going Concern to BETA, will no longer bear the losses of the Going Concern. The tangible assets functional to the performance of the economic activity of the Going Concern have a defined market value.

In order to estimate the sale price of the Going Concern, therefore, the following must be taken into consideration:

- the net asset value at the date of the disposal is equal to 90;
- the Going Concern has historically recorded significant losses; and

33. The balance sheet of the Going Concern, as at 31 Dec. 2016, consists of “net working capital” and “plant and machinery”. The assets are recorded at fair market values.

– the cost of the restructuring is assumed to be equal to 5.

The business restructuring in question allows ALPHA to obtain considerable economic benefits: the negative operating results (equal in the aggregate to -21 over the years 2014-2016) will be eliminated, while the cost of 5 for the restructuring is significantly lower.

In the present example, taking into account the fact that the Going Concern is integrated with ALPHA and under the assumption that BETA achieves arm's length results in line with those of a manufacturer in the relevant market, it should be concluded that no remuneration should be paid to BETA by ALPHA.

The sale price should therefore be reasonably determined as equal to the fair market value of the net assets at the date of transfer (90), without the acknowledgment of any additional compensation.

Moreover, whether BETA could even be compensated by ALPHA for having purchased the (loss-making) Going Concern should be questioned. To answer this question, it is opportune to check whether, under similar circumstances:

– a comparable company would have been willing to pay a compensation;

– a comparable company would have considered other options, such as ceasing to exist; or

– a third party would have been willing to purchase the loss-making business and, if so, under which conditions (*see* section 4.2.3.).

4.2.3. Evaluation of the functions, risks and assets after the restructuring

Finally, whether the rights and obligations of ALPHA – the former owner of the Going Concern – have been modified as a result of the transfer should be verified (the further assumption that the relevant sales have been made by BETA to ALPHA is also considered in this scenario).

The main functions, risks and assets that characterize BETA – after the integration of the Going Concern – are represented in Tables 6-8.

Table 6

Functions	ALPHA	BETA
Purchase of raw materials		X
Production		X
Quality control		X
Sales		X
General services		X

Compared with the situation prior to the restructuring, the main difference is that – as per the above assumption – BETA sells the semi-finished products to ALPHA, which then uses them to create the finished product. The transfer prices of the semi-finished products must be adequately regulated to ensure that BETA can obtain an arm's length profit in line with that of a manufacturer in the low labour-cost country.

Table 7

Risks	ALPHA	BETA
Market risk	X	
Warehouse risk		X
Credit risk		X
Foreign exchange risk		X

Compared with the situation prior to the restructuring, the main difference is that BETA bears the foreign exchange risk and the credit risk. The market risk is still borne by ALPHA, who sells the finished products to consumers.

Table 8

Assets	ALPHA	BETA
Plant and machinery		X
Industrial equipment		X

Compared with the situation prior to the restructuring, there is no difference.

5. Conclusions

The business restructuring outlined in the example contained in section 4. will help to protect ALPHA from future potential losses. In this example, no remuneration shall be paid to ALPHA, except for the amount equal to the market value of the net assets at the date of transfer (90), considering that ALPHA (i) obtains considerable economic benefits from the restructuring (i.e. the cost of the restructuring is significantly lower than the negative operating results consistently reported); and (ii) continues to carry out the same sale function as prior to the restructuring.

Likewise, no compensation will be paid from ALPHA to BETA for purchasing the loss-making going concern, under the assumption that the operating results of BETA are at arm's length. In other words, no compensation shall be due given that BETA indeed realizes appropriate profits from efficiently carrying out the manufacturing activity in question.