

Applying the profit split method Orange Business Norway A/S case

Orange S.A. is a multinational telecommunications company headquartered in France. Orange Business Service division is an infrastructure operator, technology integrator and supplier of value-added services. A centralized business model had created large losses at the entrepreneur level up to 2003, while the operating entities worked on a cost-plus basis. Orange Business Service launched a new business plan in January 2004 to become a "globally integrated, seamless provider of telecommunications solutions and services."

Orange Business Norway was subjected to a tax audit by the Norwegian tax authorities for the years 2004 to 2009. The tax administration found in its final conclusion that Orange Business Norway's taxable revenue had been decreased due to the Orange Business Services network's community of interest. In brief, the tax administration determined that the Profit Split Method (PSM) was not acceptable and used the Transactional Net Margin Method (TNMM) to review Orange Business Norway's taxable revenue.

In January 2020, the Court ruled in favor of Orange Business Norway. The Court of Appeal made a comprehensive assessment of the company's business and related party transactions and, in line with Orange Business Norway's arguments, concluded that the PSM was the most appropriate method for obtaining arm's length prices for Orange Business Services' "highly integrated operations". The Court of Appeal states that the PSM is typically suitable on "complex and highly integrated businesses".

During the tax review, the Tax Administration prepared a benchmark study to support the reassessment of income. The Company has strongly argued that the companies accepted as a comparable by the Administration are not sufficiently comparable. In the final rule, it was stated that all selected companies should be rejected and emphasis was placed on comparability factors such as ownership, functions performed and characteristics of the business. A striking feature of the benchmark study was that the Tax Administration had rejected loss-making companies by default. Given market conditions and the revision of the transfer pricing methodology, the decision clearly emphasizes that the analysis at the operating margin level should include companies with operating losses. Therefore, it can be concluded that loss-making entities cannot be directly rejected.

The Orange Business Norway case is a clear example of proper implementation of the PSM. The Court's decision clarifies many aspects of how a transfer pricing method should be implemented. This case re-emphasizes the importance of preparing complete and comprehensive transfer pricing documentation and functional and risk analysis.

Being able to correctly determine the best transfer pricing method and a transfer price that is in accordance with the arm's length principle, is highly linked to taxpayers' ability to analyze the structure of its Group and the nature of the intra group transactions that are performed. The functions performed, the risks borne and the assets used/contributed should be evaluated comprehensively. As in the case of Orange Business Norway, the internal pricing determined by the company was sufficiently substantiated by the functional analyzes.

It should also be noted that the Company that chooses the profit split method, should be able to thoroughly justify why it is the most appropriate method in these circumstances, the mechanism through which the method is applied, and in particular the criteria or allocation keys used for splitting the combined profits, based upon an economically valid basis.

Explanations in this article reflect the writer's personal view on the matter. EY and/or Kuzey YMM ve Bağımsız Denetim A.Ş. disclaim any responsibility in respect of the information and explanations in the article. Please be advised to first receive professional assistance from the related experts before initiating an application regarding a specific matter, since the legislation is changed frequently and is open to different interpretations.