Uncertainties on the Arm’s Length Principle for Producers and Distributors: An Old Unsolved Story …

This article takes inspiration from two recent cases that occurred in France and Uruguay to discuss the application of the arm’s length principle in general in circumstances that are similar to those regarding these cases.

1. Introduction

In this article, the author analyses the application of the arm’s length principle (ALP), starting from the facts regarding two recent cases that occurred in France and Uruguay. The facts will be extracted from the relevant litigation, and by means of additional information and assumptions, the author will discuss the application of the principle regardless of the country or even the economic sector or industry of origin. The cases concern different functions (production and distribution) of a unitary group economic activity. This article will show how the ALP can be subjectively applied, and creates uncertainty for the taxpayer. However, the conclusion is not determined by the (in the author’s view often misused) maxim that transfer pricing is not an exact science.

The uncertainty comes from the fact that the interpreters of the ALP seldom accept that “different” prices (and not only a single one) and contracts can all be compliant with the principle when they are the outcome of different possible allocations of risk and productive factors (including intangibles) in various countries. Compliance with the principle is reached when a consistent remuneration corresponds with a specific allocation of risk or factors (whether during a recession or in a boom period) and it is regardless of the declared contractual form used by parties but it does depend on the actual assumed risks and location of productive factors (the latter arising from the previous assumption of risk).

The ALP can certainly be modified, which happened for instance in 2015 via the OECD BEPS Project Actions 8-10, and can even be partly replaced by OECD Pillar One (which protects the tax base of sale countries), but modifications must occur according to the appropriate sources of law and a clear international agreement, and not because of uncommon interpretations of the current principle.

2. Summary of the Facts

In the first case, a French producer bearing innovative expenses going to partly change its previous role (it was a contract manufacturer) in the future should be allowed to share some of the group’s intangible properties. The problem arises from the fact that in a recession period (as in the years 2008-2009), the tax administrations reluctantly accept the producer’s new role involving losses (that could allow them to tax more profits in the future) but required an assured positive profit from the production function. It is not clear whether the group established that some intangible properties will be located in France in the future, deserving a share of possible extra profit later.

In the second case, a (Uruguayan) distributor was recategorized by the tax administration as a licensee performing relevant distribution functions and assuming the risk of marketing expenses in a way to be rewarded with more than a limited positive profit as it was the profit realized by independent routine distributors. This recategorization was due to a ruling on the “relevance” of the marketing activity developed by the local entity.

References

1. This article is based on information provided by influential commentators in IBFD journals (see infra n. 5, 6 and 24). The author supplied additional (assumed) information to develop his arguments. Facts regarding existing litigation between firm and tax administrations and reported in previous IBFD journals are “transformed” (with additional appropriate considerations by the author) into hypothetical examples in order to set a general rule in compliance with the ALP. They were analysed to discuss the ALP application in general and concern companies performing different functions, such as production or distribution.


The author of this article forecasted said problems, in A. Musselli, Anti-Abuse Notion of “Control over Intangible-Related Functions” Is Beyond the Arm’s Length Principle, 58 Eur. Taxn. 5 (2018), Journal Articles & Opinion Pieces IBFD. Conversely, in approving the BEPS Project in 2015, OECD made the rules less predictable because, in addition to references to uncertain concepts like group integration, interdependencies, synergies and value chain analyses, there is now also a reference to a subjective assessment related to the “importance” of intangible functions performed by parties.

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3. Requested Consistency between Reward for Production Functions and Assumed Risk of Innovating the Business

In the first example, a group is a leading manufacturer producing and trading bearings for civil and military engineering with a Swedish mother company (SB SKF), an associated producer located in France (SAS RKS)3 and with distribution entities in the countries of final sales.4

A short functional analysis identifies:
- AB SKF, the parent company that determines and implements the group’s main strategic directions;
- business units in charge of manufacturing the products such as SAS RKS (the French producer); and
- distribution units selling products to third-party customers.5

The period (2009 and 2010) audited by the French tax administration concerns the (French) company, SAS RKS. The associated distribution entities were remunerated via a resale margin of 3% on (independent) sales.6 Under the mentioned pricing rule,7 the result of the same producer (SAS RKS-France) was a net loss margin equal to:
- 10.46% in 2009; and
- 21.87% in 2010.

In a following audit, the tax administration issued an income upward adjustment (via comparables)8 by stating that the French producer was not the principal entrepreneur of the group; in that way, the tax officers said that it could not record losses but that it had made a moderate but stable profit, additionally by considering that the consolidated group result was (positive and) between 6% and 14%.9

In response, the group emphasized that SAS RKS’s functional role was larger than the role of a sole production unit, which meant that it had to bear strategic risks including:
- a development risk related to the choice to develop new products; and
- a business risk related to the efficiency of production processes.

The group argued that, from 2006 onwards, SAS RKS had chosen to reorient its positioning towards the wind turbine market, due to the drop in orders from its traditional customers. As a result of this strategic choice, the group indicated that SAS RKS had to deal with major quality problems in relation to products intended for wind turbines, particularly in the financial years 2009 and 2010. Both the group and the tax administration aimed at arriving at a specific and targeted interpretation of the ALP, regardless of a larger analysis based on the check of consistency between assumed risks and promised remuneration, for past risks regarding current reward and current risks regarding future reward.

In a recession period, as in 2009-2010, tax administrations prefer to tax a moderate but stable profit instead of having to audit a taxpayer recording losses; however, what about the periods before 2009 and 2010, when there was still a positive economic cycle? Was SAS RKS allowed to share extra profits in the “boom” periods?

The review of information about the litigation does not allow one to fully understand the mentioned issue but the author assumes that in the period before the recession SAS RKS was a contract manufacturer (and therefore not allowed to share extra profits), and that only from 2009 did it take on the risk of partly innovating the products. This implies that the current global production losses for innovation expenses could be allocated in France,10 but from the report of the case (decided in a ruling of the French Supreme Court11) there is no evidence of the contractual rules that the group set for the following periods. What are the clauses that are consistent with the new role that SAS RKS was going to perform and concerning the future periods when the economic cycle might return to positive? Should the company be allowed to retain part of its possible future (post-2009) extra profit?

The author now develops his own analysis.12

Contracts and transfer prices are decisions for group managers, but they must be made as if they were made by independent parties. Tax officers should revisit the decisions taken by group managers with information that the latter were able to know at the moment the decision was taken by group managers with information that the latter were able to know at the moment the decision was taken, by stating consistency between assumed risks and promised remuneration expenses could be allocated in France, but from the report of the case (decided in a ruling of the French Supreme Court) there is no evidence of the contractual rules that the group set for the following periods. What are the clauses that are consistent with the new role that SAS RKS was going to perform and concerning the future periods when the economic cycle might return to positive? Should the company be allowed to retain part of its possible future (post-2009) extra profit?

The starting point is the 2009-2010 recession period and the facts have already been stated previously. What happens in 2009 and 2010 must be the result of what was agreed and with regard to the investment and functions of associated companies effected before that period,13 that is, in the previous positive years of the economic cycle.
The author assumes that before the recession period, SAS RKS was a contract manufacturer whose remuneration was appropriately set via comparables. In this regard, the problems of old turbines should have affected its profit for the production function since the company was not the intangible owner of the “old” intangibles.

However, in 2009 and 2010, the group had to bear additional research expenses in order to change the product’s features and improve its declining market position.\(^{24}\)

The remuneration of SAS RKS is still set via comparables for production functions, but a determination must be made by the group regarding the investment (and, thus, expenses) for innovating the product; as the investment can negatively affect the result of SAS RKS or be reimbursed by the parent company.

The duties and rights of parties should be determined by a functional analysis and the situation would become clearer via a contract signed in the period pre-2009 and from added clauses agreed just at the beginning of 2009. The added clauses should determine the circumstances (duties and right of parties) that relate to the new research investments for periods following 2008.

Until the end of 2008, the true and sole entrepreneur was the Swedish company, which assured a reward (as resale margin) to distribution entities (via comparables) and a contract manufacturing remuneration (as markup on costs still via comparables) to SAS RKS.\(^{15}\) However, at the end of 2008, two options were equally possible.

In the first option, the group could decide to partly change the past roles of companies, giving a share of possible intangible ownership to the French company in exchange for the obligation that the same company would bear the cost of innovating products.

In the second option, the decision could be to continue the old roles, with the Swedish company charged to reimburse the costs of new investments to the French company.

If the risk of the new investments is still current,\(^{16}\) the two options are both freely possible and ALP compliant. The decision about which option to select is for group-central management with regard to the risk sharing of innovative investments. Both options are ALP compliant (in the same manner as the decision was taken by independent parties) as the actually selected condition is ruled via an appropriate contract,\(^{27}\) signed at the starting moment of transactions and before the new research investments have become sunk costs.

To summarize: at the beginning of 2009, there were two possible options and two ALP-compliant contracts:

- **First ALP-compliant contract.** After the remuneration for SAS RKS (as a contract manufacturer) is set, the costs of the investment for changing the products could be borne by the same company.\(^{18}\) This implies that the result of that company (SAS RKS) could currently be a negative result (i.e. for 2009 and 2010 when the investments are borne), depending on the amount of the new expenses when they are compared to the positive net profit for production functions (via comparables). What is not explained by the court ruling\(^{19}\) (and is unclear even in the group analysis or in the tax administration’s challenge) is that, for the future, SAS RKS would not remain a contract manufacturer, while it could share a part of the possible positive group extra result (via a profit split).\(^{20}\)

- **Second ALP-compliant contract.** SAS RKS would continue to be a contract manufacturer as in the past but that implies that research expenses for the new investments have to be reimbursed\(^{22}\) by the parent company (plus a markup).\(^{21}\) ALP compliance is strictly linked to the fact that the contract should rule that no additional remuneration will be due in future periods (after 2009) to the manufacturer (additionally to a contract manufacturing reward) also in the case of group extra profits sourcing from the improved competitive position and from the new features of the products.

Both alternatives are at arm’s length but they must be agreed upon (i.e. by a contract) in a clear way before the materialization of business risk, that is, just at the beginning of new innovative investments and when the success

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14. How to define these expenses? They are surely entrepreneurial expenses, because they are investments aimed at innovating the business.
15. The rewards of SAS RKS and of distribution entities are determined via comparable limited risk manufacturers and distributors; this could imply possible positive but also even negative royalties for the parent company.
16. The term “entrepreneur” is not a simplification with regard to a possible functional analysis short since it grants (or does not grant) the quality of the principal entrepreneur solely to the analysed entity.
17. However, how should the role of the economic agent who is going to innovate products be qualified? The sole appropriate term to describe such an agent is entrepreneur, following classical concepts of political economy. See supra n. 15.
18. The French Court argued that an assessment based on the “principal entrepreneur” concept cuts the functional analysis short since it grants (or does not grant) the quality of the principal entrepreneur solely to the analysed entity.
19. See supra n. 4.
20. Finding appropriate and objective methods to support a profit split analysis aimed at quantifying the division of a consolidated profit, taking into account old production intangibles, new production intangibles and sale intangibles, is not a simple task, how to do that is beyond the proper analysis of this paper. See also A. Musselli, Tax Transfer Pricing under the arm’s length and the safe country principles, IlSole24ore adobe digital and kindle editions (2022), at ch. 9.
21. The valuation of intangibles and the splitting of income sourcing from cooperation in the use of two intangibles is a complicated issue, and a valuer can employ different techniques that have various strengths and weaknesses
22. Under post 2015 BEPS rules (or even before, when changes of 2015 are deemed only interpretative of a pre-existent rule), a company that only reimburses the costs of innovation (without at least controlling the committed outsourced research activity) is not allowed to share intangible returns.
23. The French tax administration supported this option; however, the first decision is on the issue of whether group managers and tax officers should revisit the decisions of managers, since only when the former can assess or prove that the group contract is not ALP compliant, can they address other conditions in compliance with the principle.
or the failure of the new products has not already been disclosed. The role of the subject who is going to bear the expenses of innovating the products (or in other cases reducing their costs) is perfectly captured with the term “entrepreneur”.

4. Requested Consistency between the Reward of a Distributor and Assumed Risks in Developing Marketing Actions

A second example shows how uncertain the ALP application is, even on the distribution side: the involved parties are the US General Motors group and the (Uruguayan) tax administration. The issue is to set up an ALP-compliant remuneration for the General Motors distributor in Uruguay (GMU). GMU is a wholesale distributor of zero-kilometre vehicles in the Uruguayan market and of original spare parts and accessories.

According to the transfer pricing documentation (TP studies) filed to the tax administration (Direccion general impositiva, DGI), the transactional net margin method (TNMM) was selected as the most appropriate method, with GMU (as the Uruguayan subsidiary) being the tested party. According to this local documentation, the profit margin accrued by the taxpayer, in each fiscal year, was within the arm’s length range. The author will focus only on the aspect of the recategorization of GMU, to be considered no longer as a routine distributor but as the marketing developer of the General Motors brand in the local market.

The recategorization by the tax administration was due to two main reasons:
- the presence of a commercial licence of the brand between the group and GMU; and
- interviews with the managerial staff of GMU that revealed that they effectively carried out functions of brand positioning and maintenance of such intangibles in the market. GMU carried out various publicity campaigns in the country to launch new products, made decisions about the market, performed the functions and assumed the costs and respective risks of such actions that affected their business activity in the local market.

The tax administration thus concluded that the use of the TNMM with a profit set via routine comparables was not sufficient to capture the contribution by GMU to the final result in Uruguay because the brand was locally developed by the same distributor (GMU).

The author now will point out that making an estimation of the contribution of each associated company to the global value is complicated and how the specific rule to be applied is uncertain.

Is it possible for a distributor to assume the risks of marketing investments (whose positive outcome can be the “creation” of a valuable brand) when it is remunerated via the TNMM (and the author supposes via a comparable return on sales (ROS))?

The higher the marketing investments of the distributor are, the lower the cost of goods sold (sale for the foreign associated company) will be. In that way, the foreign producer is going to finance the marketing investments of the local distributor and the marketing investments are at risk of the former and not of the latter.

In the author’s opinion, under the circumstances of the presented case, a reward set via a ROS extracted by comparables for a routine distribution function is (one of the possible decisions) ALP compliant.

However, the 2015 BEPS Actions 8-10 have changed the norms and introduced the concept of control over risk, so that the group company contractually bearing the financial risk also has to employ people who could manage operational risks. The OECD Model has progressed from one where intangibles were owned by companies funding the capital necessary for intangibles development and assuming the risk of a negative research outcome to one where intangibles are owned by companies performing important functions related to the same intangibles with regard to their development, enhancement, maintenance, protection or exploitation (DEMPE).

The focus shifts from the risk of funding research expenses and of bearing possible “losses” to the action performed by group companies. The issue becomes quite complicated.

The group and the distributor can even sign a licence agreement that gives “freedom” to the latter on how to develop the brand, but the real issue should be which actions were actually performed by both parties (if an actual risk of losses was truly connected with the marketing investments in the country).

The previous sentence contains some significant points. The first is about the relevance of marketing actions performed by parties. The marketing actions performed by both parties of the contract must be compared and weighted against each other to understand their relative importance. How does one do that? The work can be conducted in the form of interviews with the local staff to understand their duties.

However, the author assumes that when one conducts interviews with local staff, an evaluation of the role of local staff in comparison to foreign staff (involved in the same marketing function) is possible. It would seem normal (and a human reaction) for people in a job (such as those involved in local marketing) to (in some way) try

23. Instead the French Court (Conseil d’Etat, 4 Oct. 2021, 443133, available at www.legifrance.gouv.fr), warned that a functional analysis cannot be limited to the simplistic opposition between the concepts of principal entrepreneur and routine entity. See the author’s criticism above in the text and at supra n. 15.

24. The case is mainly based on the report by M.J. Santos, Court Decision in General Motors Uruguay – The Importance of Marketing Intangibles, Local Market Characteristics and Local Comparables in a Comparability Analysis, 29 Intl. Transfer Pricing J. 1 (2022), Journal Articles & Opinion Pieces, IBFD. He comments the verdict No. 597/021 of 9 December 2021 of the Court for Contentious Administrative Matters (the highest jurisdictional body in administrative matters).

25. Return on sales (ROS) = operating profit or sales.

26. The term “risk” here implies that the marketer can even record losses.
to “enlarge” the role that they play in the global business activity. The interviews should be extended to all of the managers of the marketing function, that is, even to the managers at the top, who can be hired by the foreign associated companies. Only in that way can one compare the duties of local and foreign staff with each other, in a way to assess their relative relevance and weighting.

The second focal point relates to the possible split of the group results. Even if the interpreter is able to recognize the importance of the local distributor’s actions (in comparison with the foreign activity), how can the group companies split the extra profit generated in the local market?

The profit split application does not have its own solid concepts to be effected because it is still anchored to the performing of important functions related to intangibles, which is now to be “weighted” with the importance of functions performed by other group companies and, often, related to other intangibles of the business. Here the established problems related to marketing intangibles, when their contribution is to be weighted with production intangibles, are worsened.

If DEMPE functions are not performed by the foreign company, its financing of the marketing function should only be considered as a loan by said foreign company to the local distributor; that loan should be remunerated via an adjusted (for risk) rate of interest (even a free-of-risk rate if financing functions are not performed).

Anyone can imagine how subjective the above-mentioned assessments about the relevance (or non-relevance) of performed functions are and how many different values can arise from such a valuation process when a split of the global result is due between the foreign seller and the local distributor. Despite this, the process can be in compliance with OECD Transfer Pricing Guidelines for Multi-national Enterprises and Tax Administrations in relation to the 2015 BEPS Project Actions 8-10.

It is the author’s opinion that the DEMPE rule (on the technical point of view) allows the interpreter too much subjectivity and creates uncertainty about the tax treatment of the distributor’s reward. The author even believes that the mentioned rule is beyond the ALP, since it attaches too much importance to the performed activity of the staff rather than to the capital put at risk.

5. The ALP Cannot Fully Protect Most Developed Countries’ Tax Bases

Finally the author also affirms that both complicated and uncertain situations as presented in this article arise because it is not fully agreed by the “interpreters” of the ALP that under said principle, first of all, multinationals are free to allocate the different functions and activities in whichever location they deem appropriate. Multinationals can take into account many aspects, such as the existence and productivity of production factors, markets for outcomes, and even tax aspects and other incentives connected with different locations and countries. Genuine allocation of business risk is a practice that, in the author’s opinion, still complies with the arm’s length principle, but the problems just reside in the authenticity of the risk allocation.

The subsidiary claiming ownership of the intangible, which is therefore allowed to retain the bulk of profits, must be the party that originally assumed the risk of a positive or negative result in a competitive market.

When the ALP is the rule of law (which it is in almost all countries), the country “losing” (or believing to lose) its tax base can start an audit if the multinational business has truly developed and managed its intangibles beyond its national borders.

Only in the case that intangibles have not been genuinely (that is, ALP compliant) created or located in a foreign country can the state that claims damages be allowed to adjust the income of the group associated company that is a resident firm.

Most developed countries have experienced large budget deficits, first through the 2008 financial crisis, then in 2020 because of the COVID-19 pandemic and in 2022 because of the Russian invasion of Ukraine.

27. The conclusion about the fundamental role of the local marketer resembles the position of the US Tax Administration in the Glaxo-SmithKline case, which relates to years prior to the new millennium (from 1989 to 1996) and prior to the OECD Guidelines’ introduction of the concept of control over operational activity (OECD BEPS Actions 8-10 in 2015).

On the Glaxo case, see Marchetti Hunter, D. and Musselli A., Glaxo transfer pricing case: economic rationale, legal framework and international issues, 14 Infl. Transfer Pricing J. 1 (2007), Journal Articles & Opinion Pieces IBFD. The author aims at disclosing the “breaking point” of a transfer pricing analysis as it is the argument that is developed in the text. He wants to explain what can be the factual and/or the interpretative change that is able to underpin but also to modify such an analysis and solution. Here, the breaking point is the judgment of the interpreter of the importance of the local marketing activity with regard to the marketing functions performed by the foreign producer, regardless of which of them (the distributor or the foreign producer) is going to financially assume the risk of the marketing activity. For more detailed analysis, see supra n. 20, at Introduction and ch. 9 in example 18.

And thus to conclude that a TNMM (comparables should be routine distributors) is not able to capture the value of the local distributor’s marketing activity.

28. A. Musselli, Rise of a New Standard: Profit Location in Countries of Important Intangible Functions Managers, 24 Infl. Transfer Pricing J. 5 (2017), Journal Articles & Opinion Pieces IBFD. Even the influential authors commenting on the French ruling (Douvier, Goer, Mallaret) emphasize that a profit split analysis is much more difficult and subjective than the setting of a routine reward via comparables.


31. Additional legislative actions are designed to protect the tax base of high-tax jurisdictions. For example, high-tax jurisdictions could implement unilateral rules (like “global intangible low-taxed income”, GILTI, in the United States or controlled foreign corporations, CFC, norms in other countries, allowing them to double tax profits that under the arm’s length principle are located abroad). See A. Musselli, Business Risk Allocation: The Outermost Boundary of the Arm’s Length Principle and the Amazon Case, International Tax Journal, WK (Sept.-Oct. 2018) at 7 and following.
The ALP is not able to completely protect countries’ tax bases (it is impossible to protect the tax base of any specific country). The governments of high-taxation countries and most developed countries (as well as the public opinion in such countries) deem it unacceptable for multinationals to pursue a policy of locating profits where they are lightly taxed. The 2015 BEPS changes have not satisfied the demands of changing the situation, while the 2021 agreement on OECD Pillar One, which can truly change the matter, affects only a small number of (the largest) multinationals (when and if Pillar One is truly enforced).

The ALP cannot lock in extra profits or losses in a specific country since they are the result of a past investment activity that can be freely located. This is the intrinsic “nature” of the ALP in market economies and, if something else is wanted, it is not the association of the principle with the concept of value creation that can change the landscape, given that each firm and country’s tax administration can adjust the creation of value according to what is more convenient for their own interest.

The ALP can certainly be modified and it was modified indeed in 2015 via the BEPS Project with the concept of the DEMPE of intangible functions and can even be partly replaced by the OECD’s Pillar One. However, that must occur under the appropriate sources of law and hopefully with a clear international agreement.

What is not desirable, however, is that different interpretations of the ALP afford opportunities for unsubstantiated and aggressive actions by tax administrations or abusive behaviour by companies and create uncertainty about what is currently required by tax law.

If the purpose of the tax legislator (which also the OECD can be considered to be) is to allocate more profit to the country of sale, it is more appropriate, from the technical point of view, to set a rule as it is in Pillar One (country of sale, it is more appropriate, from the technical point of view, to set a rule as it is in Pillar One (country of sale, it is more appropriate), where the requested behaviour is not uncertain and arises from a plain mathematical interpretation of the normative text.

6. To Reduce Uncertainty on the ALP It Is Beneficial to Discuss Hypothetical Cases and Examples Regardless of the Country or the Economic Sector of Origin

Finally the author considers it beneficial to discuss specific cases and examples like those dealt with in previous articles by the influential French and Uruguayan commentators in IBFD journals. When new litigation is created, there is a special need to clarify the legal rule. Every national aspect should be ignored since the cases should not revolve around a French or a Uruguayan issue: as the facts become clear, the cases concern whichever country enforces the ALP regardless of the economic sector; they are about a producer partly changing its role as an entrepreneur or a distributor involved in marketing actions.

Groups segment their business into functions (production, distribution etc.) depending on the economic sector. What must be focused upon is how those functions are performed and therefore what are the risks and the productive factors that associated firms (performing a specific function) are going to assume and use, respectively.

Only discussions based on specific facts can improve, also after a heated debate, the state of transfer pricing rules, in the absence of an effective supranational judicial body or an effective arbitrator.

Anyone dealing with the matter in practice recognizes that the ALP is always (in all countries) proclaimed as rendering the conditions that independent parties would have agreed upon, but it is often applied in a widely different manner. It is the author’s opinion that hundreds of pages of rules describing its usage are not sufficient to give clear solutions if these are not exemplified under supposed existing circumstances, for example, in the cases that are litigated. Comparability aspects are important, but what is of greater relevance in complying with the ALP is the consistency of roles (a role is performed by assuming risk and employing capital and/or other productive factors) with agreed remuneration, i.e. for several periods and regardless of the economic sector. Establishing a contract between associated parties that is as complete as possible, displaying the duties and rights of parties, before business risks materialize can truly allow an effective check on their compliance with the principle.

33. The ALP (internationally agreed) aims at dividing the group tax base between countries, i.e. see M. Pankiv, Contemporary Application of the Arm’s Length Principle in Transfer Pricing (IBFD 2017), Books IBFD.
34. Especially because all other taxpayers (especially individuals and small businesses) are experiencing an increase and not a decrease in tax rates.
35. There is no specific ALP application for different industries, and the principle must only take into account the regulatory aspects of the economic sector where it is applied (for financial firms, for instance).
36. These are the functions in the transfer pricing vocabulary.