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Newfoundland and Labrador Hydro

Expert Report

Evaluating the Pricing Policy for Affiliate Common Services, Common Expenses and Corporate Services
June 1, 2015

Contents

1 Introduction

1.1 Terms of Engagement and Independence

This report was prepared by Brad Rolph, a Partner of Grant Thornton Consulting, a subsidiary of Grant Thornton LLP (collectively, "Grant Thornton"), at the request of the Newfoundland and Labrador Board of Commissioners of Public Utilities (the "Board") in connection with public hearings to be held regarding the 2013 amended general rate application ("2013 Amended GRA") made by Newfoundland and Labrador Hydro ("Hydro") requesting new electricity rates effective January 1, 2015.

Grant Thornton has no business relationship with any of the parties to this matter that would impair my ability to render an opinion.

1.2 Brad Rolph, MA, BA

I am the National Leader of Grant Thornton's transfer pricing practice in Canada and the Americas.[1] Transfer pricing involves evaluating the prices at which a company transfers physical goods and intangible property or provides services to a related party. The economics of transfer pricing has been my primary area of specialization since 1995.

1.3 The Assignment

The Board has asked me to use revised evidence and test year data provided by Hydro in its 2013 Amended GRA and responses to requests for information posed by the Board and the interveners to re-analyze and re-evaluate the reasonableness of the methods used by Hydro and its affiliates to determine the amounts charged by and to Hydro for services rendered or arranged by Hydro for the benefit of its affiliates or by its affiliates for the benefit of Hydro. I summited the results of my previous analysis of these methods in a report entitled "Newfoundland and Labrador Hydro: Expert Report - Evaluating the Pricing Policy for Affiliate Common Services, Common Expenses and Corporate Services" on April 25, 2014 ("the 2014 Report"). This report builds on that previous report. I have identified in this report what changes have been made to each section of the 2014 report.

1.4 Information Relied Upon

[Modified - Page 1: lines 20-25; and page 2: line 1]

In preparing my opinion, I have relied on the following information:

- The 2014 Report and the information relied upon to prepare that report;
- The 2013 Amended GRA and related appendices and exhibits submitted by Hydro to the Board;
- The responses from Hydro to the requests for any new additional information from the Board and the interveners; and
- Any additional new information, as cited throughout this report.

The opinion expressed herein is subject to the general qualification that the information on which it relies is accurate and reliable.

[1] See Appendix A for a copy of my curriculum vitae.

In preparing this report and rendering my opinion, my sole responsibility is to the Board.

I reserve the right, but will be under no obligation, to review all calculations referred to in this report and, if considered necessary by me, to revise my opinion or amend any part of this report in light of any new facts that become apparent to me subsequent to the date of this report.

1.5 Opinion

[Modified - Page 2: lines 5, 15, 24-29, 34 and 36, and page 3: lines 3-4, 17-18, 31-33 and 36-38]

With respect to the common services that Hydro renders for its affiliates, based on the information relied upon, it is my opinion that:

- Hydro renders common services (*i.e.*, services related to human resources ("HR"), safety and health, and information services ("IS")) to its affiliates that would ordinarily be considered intra-group services;
- The affiliates derive value from the common services rendered by Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activities on their own behalf in-house;
- Hydro renders common services to its affiliates for which an arm's length price should be charged;
- Using an indirect charge method to determine an arm's length price for the common services Hydro renders to its affiliates is reasonable;
- The common services-related costs to be recovered through the Administration Fee might not be fully burdened and, as a result, the amount to be charged by Hydro to its affiliates for these common services might be understated. The magnitude of the potential increase in the amounts to be charged by Hydro to its affiliates for rendering these common services would not be material;
- Allocating the HR, and safety and health-related costs to be recovered using FTEs as the allocator is reasonable;
- Allocating the IS-related costs to be recovered using average number of users as the allocator is reasonable;
- Unless the ultimate recipient of the common service rendered is an energy project involving private interests, not marking-up the common service-related costs to be recovered is reasonable. Otherwise, the costs should be marked-up by at least two percent to five percent; and
- Further clarification is warranted regarding the amount charge to and which of Nalcor's other lines of business and which external parties Hydro recovered common services-related costs.

With respect to the common expenses that Hydro initially pays on behalf of itself and its affiliate, based on the information relied upon, it is my opinion that:

- Hydro initially pays for the cost of common expenditures that benefit all of Nalcor Energy's ("Nalcor") lines of business;
- The affiliates derive value from the common expenditures initially paid for by Hydro and would have been willing to pay for these expenditures on their own behalf;
- Hydro initially pays for the cost of common expenditures which should be charged back to its affiliates;
- The common costs to be recovered are fully burdened and do not include any non-operating expenses;
- Allocating the building rental costs to be recovered using square footage occupied as the allocator is reasonable;
- Allocating the telephone infrastructure-related costs to be recovered using the average number of users as the allocator is reasonable; and

- Treating these common expenses as flow through costs and charging them back without a mark-up is reasonable.

With respect to the other expenses that Hydro initially pays on behalf of itself and its affiliates, based on the information relied upon, it is my opinion that:

- Hydro initially pays for the cost of certain other expenditures that benefit one or all of Nalcor's lines of business;
- The affiliates derive value from these other expenditures initially paid for by Hydro and would have been willing to pay for these expenditures on its own behalf;
- Further clarification is warranted regarding which of the other expenses are initially paid for by Hydro and subsequently charged back to one of Nalcor's other lines of business. Hydro should be asked to provide the dollar amount of the other expenses that were charged back to Nalcor's other lines of business;
- With the exception of some potential shareholder costs, Hydro initially pays for the cost of certain other expenditures which should be charged back to a specific affiliate or allocated amongst its affiliates at cost; and
- Treating these other expenses as flow through costs and charging them back without a mark-up is reasonable.

With respect to the corporate services that Hydro renders for its affiliates and its affiliates render for Hydro, based on the information relied upon, it is my opinion that:

- Hydro and its affiliates render corporate services that would ordinarily be considered intra-group services;
- Hydro and its affiliates derive value from the corporate services rendered by its affiliates or Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activity on its own behalf in-house;
- Hydro and its affiliates render corporate services to each other for which an arm's length price should be charged;
- It is reasonable for Hydro and its affiliates to use an direct charge method to determine an arm's length price for the corporate services it renders to its affiliates;
- The labour rates used to recover the costs of rendering these corporate services appear to be fully-burdened and do not include any non-operating expenses;
- The proxy used to calculate the portion of the labour rate intended to cover fringe benefits, including leaves of absence, should be re-evaluated on an annual basis; and
- Unless the ultimate recipient of the corporate service rendered is an energy project involving private interests, not applying a mark-up to the costs of rendering corporate services to be recovered is reasonable. Otherwise, the costs should be marked-up by at least two percent to five percent.

My opinion is based on:

- My expertise and experience in transfer pricing;
- The evidence submitted by Hydro in its 2013 Amended GRA;
- The evidence submitted by Hydro in its initial and revised responses to the requests for information;
- Publicly available documents cited in this report; and
- The evaluation framework I developed in Section 3 of this report.

1.6 Outline of the Report

[Unchanged]

The remainder of this report is structured as follows:

- Section 2: A description of the affiliate transactions;
- Section 3: A framework for evaluating the affiliate transactions;
- Section 4: Evaluating the affiliate transactions;
- Section 5: Materiality of the affiliate transactions; and
- Section 6: Conclusion.

2 A Description of the Affiliate Transactions

2.1 Overview

[Unchanged]

Virtually every multinational company must make arrangements for a variety of services to be made available to its affiliates, including administrative, technical, financial and commercial services. The same can be said of a company which has multiple divisions or affiliates within the same country, as in the case of Hydro. An independent enterprise in need of a service can acquire that service from a service provider who specializes in providing that type of service or it can perform the service in-house. Similarly, a member of an affiliate group of companies in need of a service can acquire that service directly or indirectly from independent enterprises, from one or more of its affiliates, or it can perform the service itself. Intra-group services often include services that are typically available externally from independent enterprises, such as legal or accounting services, and those that are ordinarily performed internally, such as central auditing and training.

2.2 Nalcor Energy and the Emergence of Affiliate Transactions

2.2.1 Nalcor Energy

[Modified - Page 5: line 22; and page 6: Exhibit 1]

At the time of its last general rate application in 2006, Hydro was a Crown corporation owned directly by the Province. Although there were intra-company services transactions within Hydro between its regulated and non-regulated activities and minor intercompany services transactions with its subsidiary Churchill Falls (Labrador) Corporation Limited ("Churchill Falls") which were recovered on a cost-recovery basis, it did not have any affiliate transactions involving shared services.

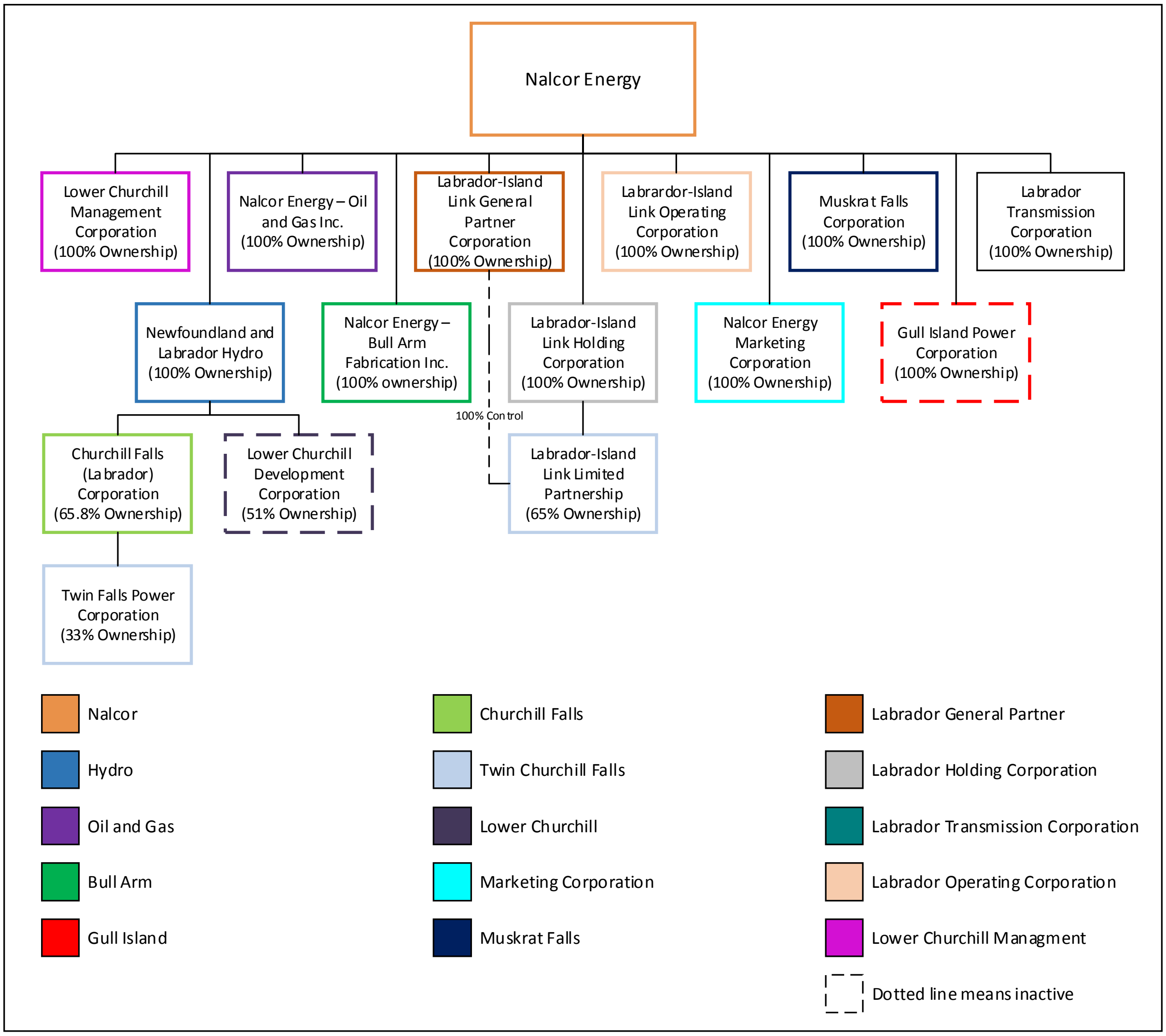
In June 2007 Nalcor was incorporated under a special act of the Legislature of the Province of Newfoundland and Labrador (the "Province") as a Crown corporation to take a lead role in the Province's participation in the development of the its energy resources. At that time, Nalcor became the parent company of Hydro, Churchill Falls and other subsidiaries owned by Hydro, and any new entity created thereafter to manage the Province's investments in the energy sector.

Today, Nalcor's business includes the development, generation, transmission and distribution of electricity; the exploration, development, production and sale of oil and gas; industrial fabrication; and energy marketing.

In Exhibit 1, I present Nalcor's legal entity structure as at November 10, 2014.[2]

[2] The following entities were added to Nalcor's legal entity structure since July 30, 2014: Lower Churchill Management Corporation, Labrador-Island Link General Partner Corporation, Labrador-Island Link Holding Corporation, Nalcor Energy Marketing Corporation, Muskrat Falls Corporation, Labrador-Island Link Operating Corporation, and Labrador Transmission Corporation.

Exhibit 1
Nalcor Energy
Legal Entity Organization Chart
November 10, 2014



Source: Hydro's 2013 Amended GRA Exhibit 8, page 1, Figure 1.

2.2.2 Lines of Business

[Modified - Page 6: line 8]

Nalcor has segmented its business into seven reporting units:

- Hydro;
    - Hydro Regulated
    - Churchill Falls
    - Energy Marketing
- Nalcor Energy - Oil and Gas Inc. ("Oil & Gas");
- Nalcor Energy - Bull Arm Fabrication Inc. ("Bull Arm Fabrication");
- Phase 1 Lower Churchill Project ("Lower Churchill Project"); and

- Corporate services and other activities.[3]

2.2.2.1 Newfoundland and Labrador Hydro

[Unchanged]

Hydro is the primary generator and transmitter of electricity in Newfoundland and Labrador. During 2012, Hydro supplied about 87 percent of the Province's electricity needs serving about 279,000 utility, industrial, residential and commercial customers in over 200 communities. It has $1.4 billion of capital assets located throughout the Province.

Within Hydro are three of Nalcor's seven reporting units: Hydro Regulated, Churchill Falls and Energy Marketing.

2.2.2.1.1 Hydro Regulated

[Modified - Lines 8, 10-11 and 14-16]

Hydro Regulated sells electricity to three primary customer groups:

- Newfoundland Power, an investor-owned utility that distributes electricity to over 255,000 customers on the island portion of the Province; Hydro Regulated supplies 93 percent of its energy requirements comprising 82.4 percent of regulated revenue;
- Over 38,000 residential and commercial customers in rural Newfoundland and Labrador comprising 14.6 percent of regulated revenue; and
- Major industrial customers primarily in the pulp and paper, mining and oil refining industries comprising 3.0 percent of regulated revenue. Vale has built a new nickel smelter and is in the process of ramping up its activity and consumption. Value is currently the second smallest Hydro industrial customer; by 2017 it is expected to be Hydro's largest industrial customer as a result of the new nickel processing operations.

2.2.2.1.2 Churchill Falls (Labrador) Corporation

[Unchanged]

Churchill Falls operates one of the largest underground hydroelectric powerhouses in the world, with a rated capacity of 5,428 megawatts ("MW").

Hydro holds a 65.8 percent interest in Churchill Falls. The remainder is held by Hydro-Quebec.

2.2.2.1.3 Energy Marketing

[Unchanged]

The revenue and earnings realized by this reporting unit are derived primarily from sales of electricity to export markets in eastern Canada and the northeast United States as well as to the iron ore industry in Labrador. To access export markets, Nalcor has service agreements with Hydro-Quebec for 265 MW of long-term electricity transmission capacity from Labrador through Quebec to the Canada-United States border. This segment also includes the operations of the Menihek Generating Station which supplies power to Hydro-Quebec for its customers in the Schefferville region.

2.2.2.2 Nalcor Energy - Oil and Gas Inc.

[Unchanged]

Nalcor is a minority partner in three off-shore oil producing developments: the Hebron oil field, the White Rose Growth Project, and the Hibernia Southern Extension. Oil and Gas is also executing a comprehensive exploration strategy to accelerate the discovery of new resources in offshore locations.

[3] The description of each reporting unit has been derived from Nalcor's 2013 Annual Report, pages 17 to 20. Nalcor did not update the descriptions nor the data in its 2014 Annual Report.

2.2.2.2.1 Hebron Oil Field

[Unchanged]

The Hebron oil field is operated by ExxonMobil, which has a 36 percent interest in the project. ExxonMobil took control of the project from Chevron in October 2008. The joint venture partners in the field development are Chevron Canada Resources (26.7 percent), Petro-Canada (22.7 percent), StatoilHydro (9.7 percent) and the public sector company Energy Corporation of Newfoundland and Labrador ("ECNL") (4.9 percent).[4]

2.2.2.2.2 White Rose Growth Project

[Unchanged]

The White Rose Growth Project is operated by Husky Energy (68.875 percent) on behalf of Petro-Canada (26.125 percent) and the Government of Newfoundland and Labrador who, through Nalcor, holds a 5 percent equity stake.[5]

2.2.2.2.3 Hibernia Southern Extension

[Unchanged]

The Hibernia oil field is operated by ExxonMobil and owned by ExxonMobil Canada (27.4 percent), Chevron Canada Resources (23.6 percent), Petro-Canada Hibernia Partnership (Suncor) (19.5 percent), Statoil Canada Ltd. (10.5 percent), Nalcor Energy (10.0 percent), Canada Hibernia Holding Corporation (5.1 percent), and Murphy Oil (3.9 percent).[6]

2.2.2.3 Nalcor Energy - Bull Arm Fabrication Inc.

[Unchanged]

Bull Arm Fabrication is Atlantic Canada's largest industrial fabrication site and generates revenue through leasing arrangements with large construction projects.

2.2.2.4 Phase 1 Lower Churchill Project

[New]

Phase 1 of the Lower Churchill Project ("Phase 1 Lower Churchill Project") was sanctioned on December 17, 2012.[7] The project includes an 824 MW hydroelectric facility at Muskrat Falls on the lower Churchill River in Labrador, over 1,500 km of associated transmission lines in Newfoundland and Labrador linking the island of Newfoundland to Labrador, and the Maritime Link between the island of Newfoundland and Nova Scotia. The hydroelectric facility and the transmission lines in the province are being constructed by Nalcor and the Maritime Link is being constructed by Emera Inc. ("Emera").

2.2.2.5 Corporate Services and Other Activities

[Modified - Lines 21-22]

This reporting unit includes corporate support functions, business development activities and certain development activities that have not yet progressed to sanction decision including Phase 2 of the Lower Churchill Project ("Gull Island" or "Phase 2 Lower Churchill Project").

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[4] http://www.offshore-technology.com/projects/exxon_hebron/
[5] http://www.offshore-technology.com/projects/white_rose/
[6] http://www.hibernia.ca/hse.html
[7] Phase 1 Lower Churchill Project was referred to as Muskrat Falls Project in Nalcor's 2012 Annual Report.

2.3 Organizational Structure of Newfoundland and Labrador Hydro

[Unchanged]

Although Nalcor is not subject to regulation by the Board, the transfer of certain leadership positions from Hydro to Nalcor at the time it was created resulted in significant changes to Hydro's organizational structure and the need for affiliate transactions. As shown in Exhibit 2 and Exhibit 3, Hydro is organized into three functional areas: Operations, Systems Operations and Planning, and Corporate Services.[8]

2.3.1 Operations

[Unchanged]

Operations is led by the Vice President of Newfoundland and Labrador Hydro who is responsible for the operation and management of Hydro's generation, transmission, distribution and communications assets from asset inception to retirement. Operations is organized into three functional areas that are responsible for facilities used to provide regulated service to the Province: Hydro Generation, Thermal Generation and Transmission and Rural Operations. As depicted in Exhibit 2, with one exception, the Vice President of Hydro and Managers responsible for the functional areas within Operations are based with Hydro. The Manager of Exploits and Menihek Generation is employed by Nalcor.

2.3.2 System Operations and Planning

[Modified - Page 9: lines 13-16; and page 10: Exhibit 2]

Systems Operations and Planning was formed as a standalone division of Hydro in April 2013. It is an amalgamation of the former System Operations and System Planning departments and carries out all of the activities previously performed by the two departments. In addition, the new division will lead the operational transition related to the integration of Muskrat Falls and the connection of the current Isolated Island system to the North American grid.

Systems Operations manages the operation of the Island and Labrador Interconnected Systems through the Energy Control Centre ("ECC"). Systems and Operations also has responsibility for assessing and reporting power system performance, scheduling major equipment outages to enable effective system maintenance and upgrades, providing engineering support to the ECC, forecasting thermal plant fuel requirements and power purchase expenses, and communicating with Industrial Customers and Newfoundland Power to coordinate outage planning, switching, and power delivery arrangements. It previously reported to Operations.

System Planning is responsible for preparing operational and long-term planning load forecasts for interconnected and isolated power systems, recommending system modifications or expansions and completing system studies, and preparing thermal fuel price projections.

The Vice President, Systems Operations and Planning is based within Hydro as are the divisional managers.

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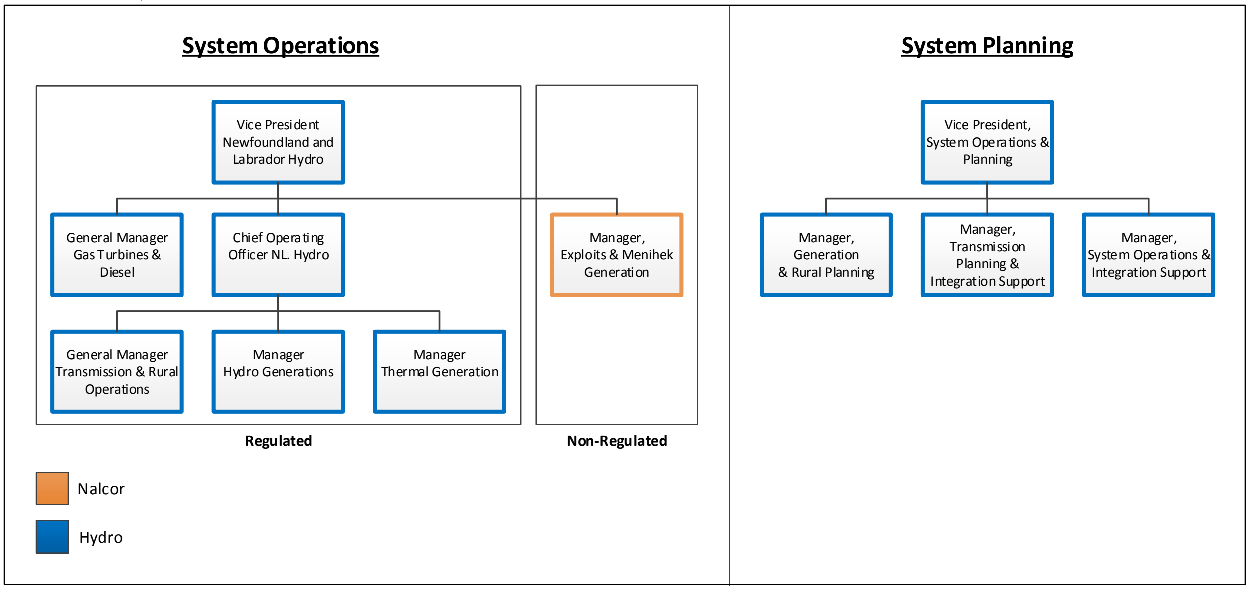
[8] See Hydro's 2013 Amended GRA, Exhibit 1, Section 1.0.

Exhibit 2
Newfoundland and Labrador Hydro
Organization Structure
System Operations and Planning
November 10, 2014



Source: Hydro's 2013 Amended GRA, Exhibit 1, Schedule 1, pages 3, 4, 5, 6, and 7.

2.3.3 Corporate Services

[Modified - Page 10: line 2; page 11: Exhibit 3]

Corporate Services is organized into four divisions: Project Execution and Technical Services ("PETS"), Finance, HR and Organizational Effectiveness, and Corporate Relations. Nalcor's General Counsel and Corporate Secretary as well as its Internal Audit functions are also within this reporting unit.

2.3.3.1 Project Execution and Technical Services

[Unchanged]

The PETS division is responsible for rendering services to support asset management through the Office of Asset Management ("OAM"), the technical needs of the business and completion of the design, planning and delivery of operating and capital projects.

2.3.3.2 Finance

[Unchanged]

The Finance division includes separate departments for Finance and Corporate Services, Rates and Regulation, Financing, and Investment Evaluation.

2.3.3.3 Human Resources and Organizational Effectiveness

[Modified - Line 9]

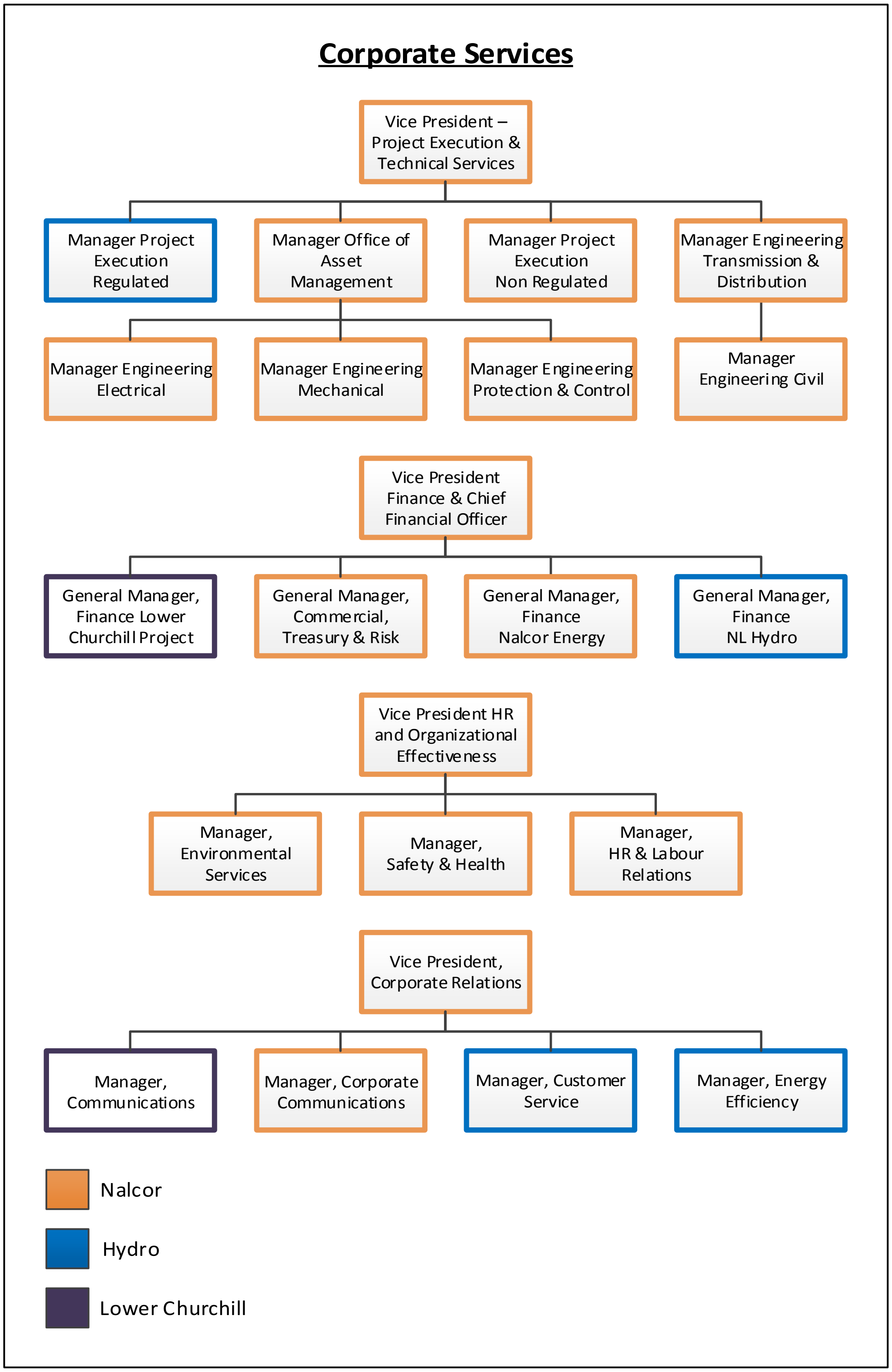
The HR and Organizational Effectiveness division includes separate departments for Environmental Services, Safety and Health and HR.

2.3.3.4 Corporate Relations

[Unchanged]

The Corporate Relations division includes Communications staff and separate departments for Customer Service and Energy Efficiency.

Exhibit 3
Newfoundland and Labrador Hydro
Organization Structure
Corporate Services
November 10, 2014



Source: Hydro's 2013 Amended GRA, Exhibit 1, Schedule 1, pages 8, 9, 11, and 12.

2.4 Services Rendered by Newfoundland and Labrador Hydro

2.4.1 Common Services

[Unchanged]

Hydro provides the following common services to Nalcor and its other business lines:

- HR;
- Safety and Health; and
- IS.[9]

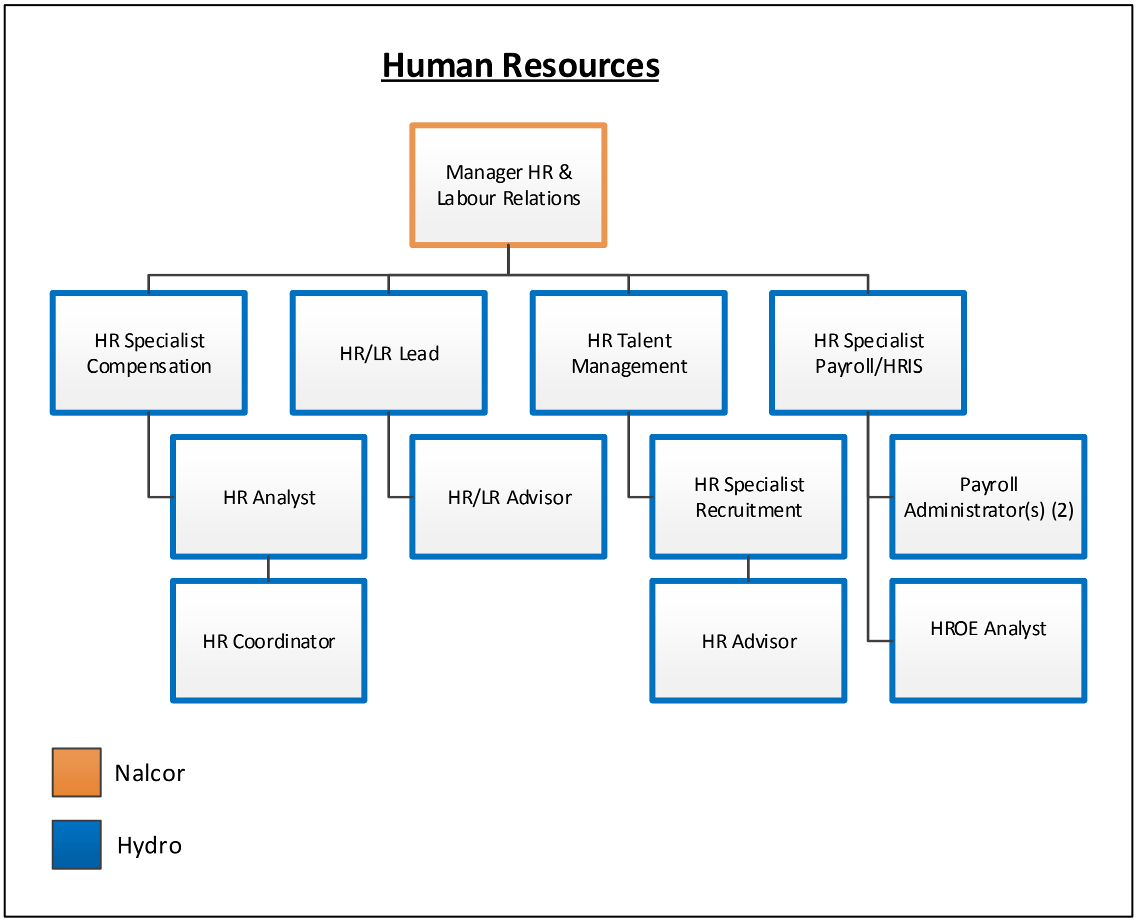
2.4.1.1 Human Resources

[Modified - Page 12: lines 5, 7 and 10-11; and page 13: Exhibit 3]

Hydro's HR department consists of 12 employees who are responsible for the administration and coordination of all employee-related services including payroll, recruitment, employee benefit programs, pensions, training and the rewards and recognition program as well as the maintenance of the HR database.[10] Any changes to HR policies and programs are the responsibility of the HR department. The HR department also administers the performance appraisal system, conducts salary surveys, maintains organization charts, and responds to grievance resolution, arbitration cases, and collective bargaining negotiations.[11] As shown in Exhibit 4, Nalcor's only HR-related employee is the Manager of HR & Labour Relations.

[9] See Hydro's 2013 Amended GRA, Exhibit 8, page 3.
[10] See Hydro's 2013 Amended GRA, Exhibit 8, page 3.
[11] See Hydro's 2013 Amended GRA, PUB-NLH-173, page 10.

Exhibit 4
Newfoundland and Labrador Hydro
Organizational Structure
Human Resources Department
December 9, 2014



Source: Hydro's 2013 Amended GRA, PUB-NLH-138-R2, page 4.

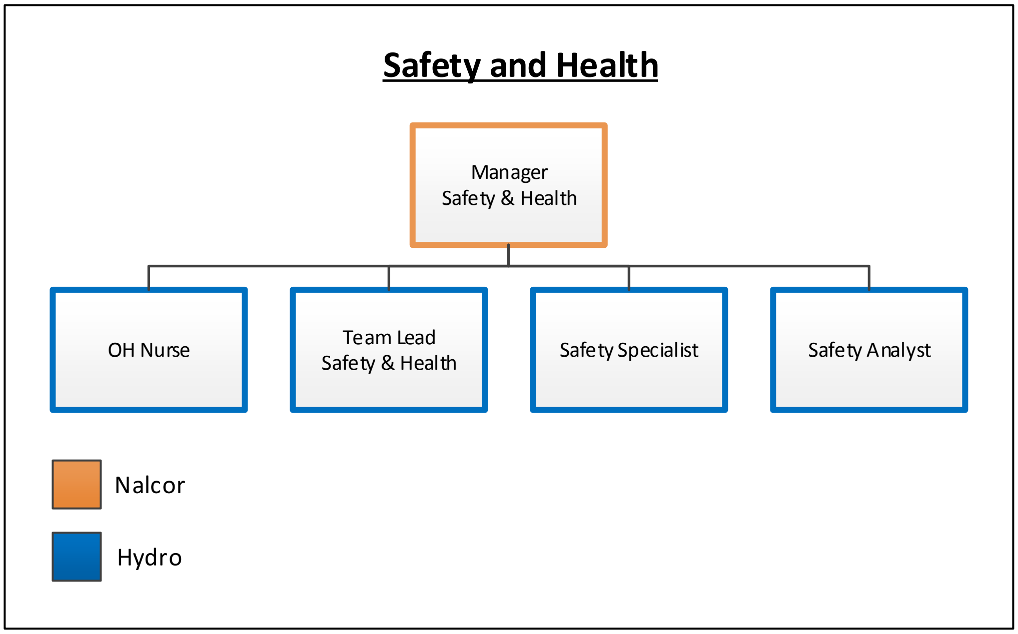
2.4.1.2 Safety and Health

[Modified - Page 13: line 2-3; and page 14: Exhibit 5]

The Safety and Health department provides occupational health services including coordinating corporate efforts with regard to employee safety as well as wellness, disability and sick leave management, and medical screening.[12] As shown in Exhibit 5, Nalcor's only Safety and Health-related employee is the Manager of Safety and Health.

[12] See Hydro's 2013 Amended GRA, Exhibit 8, page 3.

Exhibit 5
Newfoundland and Labrador Hydro
Organizational Structure
Safety and Health Department
December 9, 2014



Source: Hydro's 2013 Amended GRA, PUB-NLH-138-R2, page 4.

2.4.1.3 Information Systems

[Modified - Page 14: line 2; and page 15: Exhibit 6]

The IS department provides assistance and support in the areas of software applications, planning and integration, and business solutions.[13] This department is also responsible for the maintenance and administration of the company-wide computer infrastructure and network and provides technical support. As shown in Exhibit 6, Nalcor's only IS-related employee is the Manager of IS.

2.4.2 Common Expenses

[Unchanged]

Hydro also charges Nalcor and its other business lines for the use of:

- Office space;
- Telephone infrastructure, including the Local Area Network ("LAN"); and
- Other expenses not covered by the Administration Fee.

2.4.2.1 Office Space

[Modified - Heading and line 9]

Nalcor's other lines of business occupying floor space at Hydro Place receive a rental charge from Hydro.[14]

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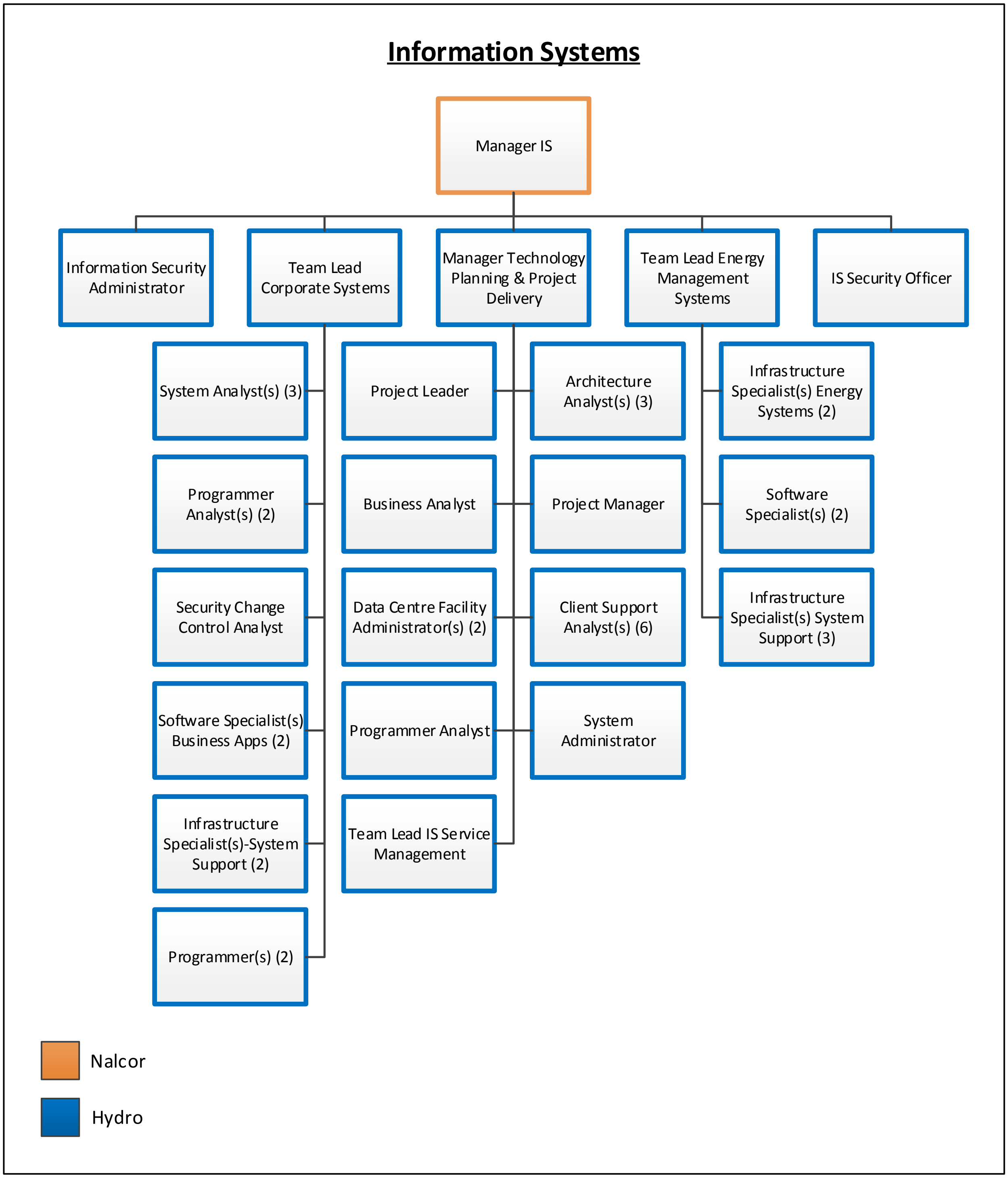
[13] See Hydro's 2013 Amended GRA, Exhibit 8, page 3.
[14] See Hydro's 2013 Amended GRA, Exhibit 8, page 4.

Exhibit 6
Newfoundland and Labrador Hydro
Organizational Structure
Information Systems Department
December 9, 2014



Source: Hydro's 2013 Amended GRA, PUB-NLH-138-R2, page 7.

2.4.2.2 Telephone Infrastructure

[Modified - Line 2]

Nalcor's other lines of business receive a charge from Hydro for their share of telephone infrastructure costs, including long distance charges.[15]

2.4.2.3 Other Expenses

[Modified - Line 4]

Hydro initially incurs other expenses that are not part of the Administration Fee that benefit one or more of Nalcor's other lines of business.[16] These expenses include:

- Advertising expenses administered by Nalcor;
- Audit expenses;
- Cell phone expenses;
- Corporate memberships;
- Directors' expenses;
- Directors' fees;
- Freight and courier expenses;
- Group insurance - premiums;
- Insurance expenses;
- Nalcor annual report and annual general meeting expenses; and
- Treasury related fees.

2.4.2.4 Fees Charged by Newfoundland and Labrador Hydro to Affiliates for Services Rendered

[Modified - Page 16: lines 16-21; and page 17: Table 1]

As shown in Table 1, Hydro charged its affiliates about $5.6 million for common services, common expenses and other expenses during 2013. Roughly 78 percent of these charges were for shared IS services and allocated office space.

Hydro anticipates that the Administration Fee to be charged to its affiliates will be slightly higher in the 2104 test year and again in the 2015 test year. Through its Administration Fee, Hydro expects to recover about 4.5 percent of its operating expenses during the 2014 test year and 4.1 percent during the 2015 test year.[17]

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[15] See Hydro's 2013 Amended GRA, Exhibit 8, page 5.
[16] See Hydro's 2013 Amended GRA, Section 3, page 3.43.
[17] See Hydro's 2013 Amended GRA, Section 3, Finance, Schedule I, Page 9 and PUB-NLH-169 (Revision 2).

Table 1 Newfoundland and Labrador Hydro Administration Fee Cost Allocations December 31, 2011-2015 CAD 000s					
	2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
Common Services					
Human Resources	525.6	636.7	698.3	756.3	827.8
Safety and Health	323.0	348.5	386.4	397.6	430.4
Information Systems	1,722.2	2,507.0	2,814.0	2,568.2	2,944.0
Common Expenses					
Office Space	777.5	1,819.1	1,569.9	1,762.7	1,299.7
LANS	37.4	49.1	37.7	44.0	82.0
Telephones	56.1	73.7	87.4	101.9	69.7
Other Miscellaneous	2.1	2.4	N/R	N/R	N/R
Total Administration Fee	**3,443.9**	**5,436.6**	**5,593.7**	**5,630.7**	**5,653.5**

Source: Hydro's 2013 Amended GRA, PUB-NLH-169-R2.
Note: Numbers might not add due to rounding.

2.5 Corporate Services Rendered to and by Newfoundland and Labrador Hydro

[Unchanged]

Corporate services rendered by Nalcor or one of its other lines of business to Hydro are charged out to Hydro. Similarly, corporate services rendered by Hydro to Nalcor or one of its other lines of business are also charged out accordingly. Nalcor and its lines of business, including Hydro, provide the following corporate services:[18]

- Management;
- General accounting;
- Treasury;
- Engineering;
- Project execution and administration;
- Purchasing; and
- Legal.

[18] See Hydro's 2013 Amended GRA, Exhibit 8, page 2 and PUB-NLH-229.

2.5.1 Management

[Modified - Lines 3-4 and 8]

The executive leadership team at Nalcor provides strategic oversight and general management. The team consists of the following employees:

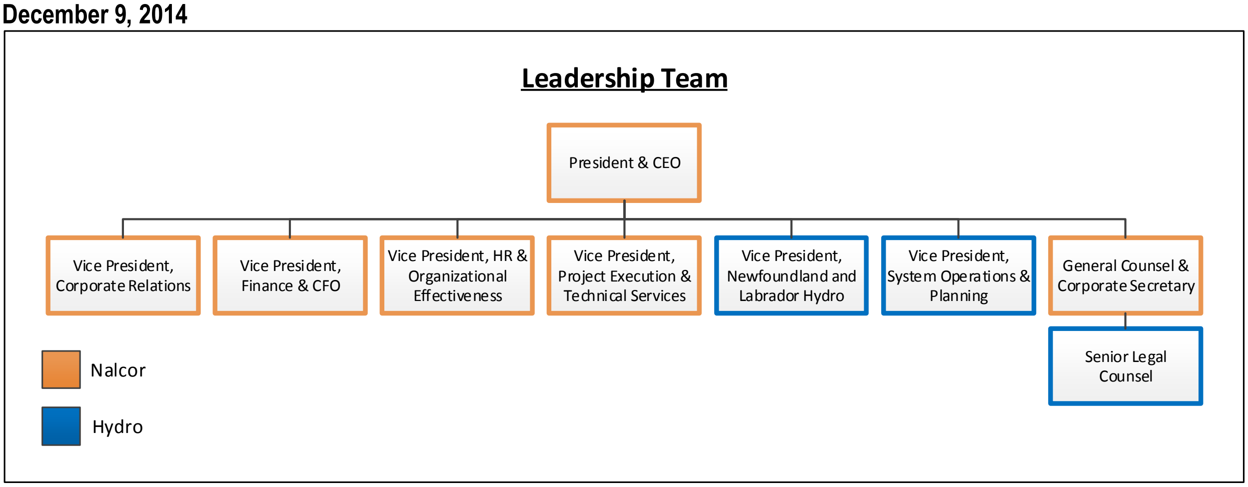
- President and Chief Executive Officer ("CEO");
- Vice-President, Finance and Chief Financial Officer ("CFO");
- Vice-President, Newfoundland and Labrador Hydro;
- Vice-President, System Operations and Planning;
- Vice-President, Project Execution and Technical Services;
- Vice-President, HR and Organizational Effectiveness;
- General Counsel and Corporate Secretary;
- Vice-President, Corporate Relations; and
- Manager of Internal Audit.

In addition to being the President and CEO of Nalcor, Mr. Ed Martin is also the President and CEO of the following entities:

- Hydro;
- Churchill Falls;
- Oil and Gas; and
- Bull Arm Fabrication.

The President and CEO is accountable to the Board of Directors of Nalcor for the general direction, supervision and control of the activities of Nalcor and its affiliated companies.

Exhibit 7
Newfoundland and Labrador Hydro
Leadership Team
December 9, 2014



Source: Hydro's 2013 Amended GRA, PUB-NLH-138-R2, page 1.

2.5.2 Finance

[Modified - Line 2]

The Finance department provides accounting and treasury services including external financial reporting.

The Vice-President, Finance and CFO is responsible for providing leadership and direction within Nalcor and across all of Nalcor's lines of business in the functional areas of controllership, taxation, information systems, supply chain, treasury, financing, risk management, investment evaluation, financial planning, and rates and regulation.

2.5.3 Financial Planning

[Unchanged]

The Investment Evaluation department provides services to facilitate the production, review and distribution of annual long-term financial plans. As well, they provide long-term financial planning and analyses for various activities. The department's responsibilities include, but are not limited to:

- Financial evaluation of potential investment opportunities;
- Medium and long-term financial planning;
- Due diligence activities;
- Activities to support Federal Loan Guarantee negotiation and implementation;
- Develop and maintain corporate financial and economic assumptions; and
- Support financial analysis for key strategic corporate initiatives.

2.5.4 Project Engineering and Technical Services

[Unchanged]

The PETS department includes senior project execution managers, discipline managers, engineers, and other staff that provide services in all engineering disciplines and covers such items as:

- Design, construction and project management;
- Engineering studies, technical specifications and construction coordination;
- Tender preparation and analysis including interaction with consultants; and
- Review and resolution of maintenance problems.

2.5.5 Labour Relations

[Unchanged]

The Labour Relations department provides services related to negotiating and administrating collective agreements, the resolution of grievances and all union/management communications. In addition, the department is responsible for the following:

- Recruitment and orientation;
- Compensation strategy and job evaluation administration;
- Performance management;
- Leadership development and training administration;
- Payroll and benefits administration;
- Succession and workforce planning;
- Employee engagement;

- Organization design and process/team improvement advisory services; and
- Collective bargaining, collective agreement advisory services, dispute resolution and ongoing labour-management relations.

2.5.6 Environmental Services

[Unchanged]

The Environmental Services department is responsible for auditing for compliance with government regulation and corporate policy, obtaining permits and approvals for proposed programs and advising on environmental matters. In addition, the department is responsible for the following:

- Maintenance of the ISO 14001 Environmental Management System;
- Coordination/oversight of the Company's annual continuous improvement plan;
- Environmental advisory/support services (environmental permitting; environmental emergency response; environmental protection plans; environmental impact assessment; etc.); and
- Project surveillance and compliance auditing.

2.5.7 Legal

[Unchanged]

The General Counsel and Corporate Secretary is responsible for providing legal and corporate secretarial services, governance and co-ordination of the Access to Information and Protection of Privacy Act, the Citizens Representative and Conflict of Interest matters to Nalcor and its affiliated companies including all of its lines of business.

2.5.8 Risk and Insurance

[Unchanged]

The Risk and Insurance department provides services related to the placement, policy and claims administration, risk control and risk financing of the corporate insurance program.

2.5.9 Supply Chain Management

[Unchanged]

The Supply Chain Management department coordinates all efforts related to procurement process activities including tendering, purchasing, and contract administration.

2.5.10 Internal Audit

[Unchanged]

The Internal Audit Department provides auditing services as determined in an annual audit plan as part of the annual update of the Five-Year Internal Audit Plan.

2.5.11 Fees Charged by Affiliates to Newfoundland and Labrador Hydro for Corporate Services Rendered

[Modified - Heading, lines 1-4, and Table 2]

As shown in Table 2, Hydro paid its affiliates, predominantly Nalcor, about $3.8 million for corporate services rendered during 2013.[19] Roughly 71 percent of these charges were for services rendered by the PETS and Finance divisions. Hydro anticipates that the fees charged by its affiliates for corporate services rendered will grow by 29 percent during 2014 test year and decline by 36 percent during 2015 test year.

Table 2
Newfoundland and Labrador Hydro
Corporate Services Charged by Affiliates
December 31, 2011-2015
CAD 000s

	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Test Year)	2015 (Test Year)
Executive Leadership & Assoc.	438.0	311.0	307.0	913.0	853.0
Legal	57.0	77.0	36.0	179.0	144.0
Internal Audit	116.0	99.0	130.0	114.0	109.0
Project Engineering and Technical Services	824.0	986.0	1,642.0	2,502.0	1,086.0
Environmental Services	40.0	48.0	35.0	55.0	53.0
Financial Planning Services	175.0	103.0	33.0	43.0	113.0
Risk and Insurance	74.0	75.0	89.0	77.0	133.0
Finance Services	580.0	663.0	1,031.0	436.0	277.0
Supply Chain Management Services	38.0	58.0	63.0	72.0	0.0
Corporate Relations	170.0	160.0	164.0	195.0	69.0
Human Resources	64.0	106.0	128.0	151.0	191.0
Supply Chain Management Services	68.0	81.0	99.0	115.0	90.0
Total	**2,643.0**	**2,766.0**	**3,759.0**	**4,852.0**	**3,118.0**

Source: Hydro's 2013 Amended GRA, PUB-NLH-423 Attachment 1.
Note: Numbers might not add due to rounding.

2.5.12 Fees Charged by Newfoundland and Labrador Hydro to Affiliates for Corporate Services Rendered

[Modified - Page 21: heading and lines 5-8; page 26: lines 1-2 and Table 3]

As shown in Table 3, Hydro charged its affiliates, predominantly Nalcor, about $3.7 million for corporate services rendered during 2013. Roughly 31 percent of these charges were for systems planning and engineering services through the PETS department, and finance and corporate services through the Finance department. Hydro anticipates that its fee for corporate services rendered to its affiliates will increase by 3 percent during the 2014 test

[19] The inputs to the Co-op Commerce bill rate were determined by estimating an annual salary of $40,000, benefits of $8,000, and 1,850 hours of working time per year. The HAY Grade Hourly calculation is the total salary plus benefits divided by the total number of hours worked per year. The bill rate calculation is the Hay Grade Hourly multiplied by a mark-up of 57 percent. Numbers might not add due to rounding.

year and again by 2.7 percent during the 2015 test year. Through its Corporate Services Charge, Hydro expects to recover about 3.1 percent of its operating expenses during the 2014 test year and 2.9 percent in the 2015 test year.[20]

Table 3
Newfoundland and Labrador Hydro
Corporate Services Charged to Affiliates
December 31, 2011-2015
CAD 000s

	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Test Year)	2015 (Test Year)
Corporate Relations	20.9	34.0	25.0	11.4	53.0
Executive Leadership & Assoc.	84.1	75.0	134.6	35.6	64.3
Finance/CFO	881.0	963.0	1,101.7	1,130.8	1,258.5
Human Resources & Org. Effect.	271.3	270.1	214.0	224.1	261.0
Project Execution & Tech Serv.	1,965.5	884.7	1,165.2	1,074.4	1,086.8
Regulated Operations	598.2	571.8	625.2	1,091.4	646.8
Systems Operations & Planning	450.5	529.6	468.8	280.9	581.8
Total	**4,271.6**	**3,328.2**	**3,734.5**	**3,848.5**	**3,952.1**

Source: Hydro's 2013 Amended GRA, PUB-NLH-170-R2.
Note: Numbers might not add due to rounding.

2.6 Terms and Conditions

2.6.1 Billing and Collections

[Modified - Line 10]

According to Nalcor's intercompany guidelines, invoices for the recovery of affiliate transactions are to be issued on a monthly basis. Billings to and from affiliates are to be undertaken within 30 days of the service, resource or asset being provided. Receivables between affiliates are to be paid upon invoice receipt from an affiliate. If the invoice is not paid in full within 30 days from the date of invoice, Treasury and Risk Management will calculate an intercompany interest charge. The amount of the interest charge is to be such that there is no net financing impact on the affiliate to which the balance is owed. Finance charges are calculated by applying a rate to the intercompany balance(s) that is equal to the cost of short-term financing for the affiliate to which the balance is owed. If the affiliate to which the balance is owed is Hydro, then the rate applied to such a balance is the last approved weighted average cost of capital ("WACC"), which is currently 7.53 percent.[21].

[20] See Hydro's 2013 Amended GRA, Section 3, Finance, Schedule I, Page 9 and PUB-NLH-170 (Revision 2).
[21] See Hydro's 2006 GRA, Schedule I, page 4.

3 A Framework for Evaluating the Affiliate Transactions

3.1 Introduction

[Unchanged]

When unrelated companies transact with each other, the price of the goods bought and sold or the services rendered and received are determined by market forces. When related companies transact with each other, market forces might not be present. This situation creates the potential for mispricing, and in the case of Nalcor and Hydro the mispricing might affect the rate at which users pay for electricity in the Province.

In addition to my expertise and experience in transfer pricing, I considered the guidance provided by the following sources to develop a framework upon which to evaluate the reasonableness of the methods used by Hydro and its affiliates to determine the amounts charged by and to Hydro for services rendered or arranged by Hydro for the benefit of its affiliates or by its affiliates for the benefit of Hydro:

- Managerial and cost accounting literature;
- Industry practice; and
- Tax administration guidance.

3.2 Managerial and Cost Accounting Literature

[Unchanged]

I considered the guidance provided in the management accounting literature as a starting place for my evaluation framework. In particular, I relied, in part, on the following sources:

- The Society of Management Accountants of Canada ("SMAC"), 1999, *Adopting and Implementing Shared Services*, Management Accounting Guideline. Mississauga, ON: The Society of Management Accountants of Canada;
- Horngren, Charles T., Gary L. Sundem, William O. Stratton, and Philip Beaulieu, 2012, *Management Accounting, Sixth Canadian Edition*, Toronto, Ontario, Pearson Canada Inc. ("Horngren"); and
- Bragg, Steven M., *Management Accounting Best Practices - A Guide for the Professional Accountant*, Hoboken, New Jersey, John Wiley & Sons, Inc. ("Bragg").

These sources describe the principles of shared services and provide guidance with respect to two relevant concepts: fully loaded cost and activity-based costing.

3.2.1 Principles of Shared Services

[Modified - Line 3]

Shared services, sometimes referred to as shared internal services, or shared common services and corporate services, is a business strategy that involves sharing and leveraging resources, people and information to more effectively and efficiently render internal services such as finance, HR, information technology systems, corporate communications and purchasing. The strategy is used predominantly by large and medium-sized organizations in the private sector to:

- Reduce overall costs of providing internal services;
- Minimize duplication of internal services across the business units of the organization;
- Improve service levels; and
- Help the business units focus on their core business.

Lately, shared services strategies have been adopted by public sector agencies as a solution to funding limitations.[22]

Although it incorporates elements of each, a shared services strategy is fundamentally different from the centralized, decentralized and, more recently, outsourcing models used to provide internal services. The basic model of shared services first centralizes internal services as a means to control costs and then charges users for those services on a fully loaded cost recovery basis. The fully loaded charge for internal services provides users with a realistic picture of what it actually costs to render the internal services they require.

3.2.2 Fully Loaded Costs

[Unchanged]

A fully loaded cost for rendering an internal service includes all of the direct and indirect costs associated with rendering the internal service. Traditional methods of allocating the costs of rendering internal services do not necessarily include costs of a general overhead nature, such as costs relating to office facilities, telephone, computer hardware and software, and management. A fully loaded cost should include an amount to cover these types of expenses as well as depreciation, finance charges and taxes. In an asset-intensive service, such office facilities, the cost of capital and depreciation also need to be built into the internal charge.[23]

One of the common principles of pricing is to keep the model simple and have as few assumptions as possible. The more pricing models that are used the higher the costs of maintaining them. Detailed pricing on a per unit or hourly basis should be avoided in favour of more broadly defined fees. It is important to keep to a minimum the costs associated with pricing and billing internal services.

3.2.3 Activity-Based Costing

[Modified - Page 25: line 15; page 26: Table 4 heading]

Identifying all costs associated with rendering internal services can be a difficult and time-consuming exercise. Some organizations have internal costing systems that enable them to identify specific charges related to an internal service. Others have to rely on the best available data or more complex means such as activity-based costing ("ABC").

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[22] See SMAC, page 2.
[23] See SMAC, page 12.

ABC establishes a cause-and-effect relationship between the internal services rendered, their related costs and their resulting output by tracing and allocating the costs by the activities performed to render the internal service. The steps involved to use ABC to determine the costs of internal services are:

- Identifying the services for which costing will be borne;
- Defining the activities performed to produce, market, and deliver the service;
- Identifying the causes of resources being consumed and activities being performed;
- Attributing direct and indirect costs to the activities being performed;
- Linking activities and costs to the services; and
- Managing and controlling the business process activities and their cost drivers.[24]

In other words, for each internal service that is rendered, the costs of providing those services are to be determined and allocated to the recipients of the services based on a metric closely linked to the service rendered. The groups of individual costs borne to render the services that are to be recovered are sometimes referred to as cost pools. When used for allocating costs, a cost driver is often called a cost-allocation base.[25] It is an activity driver that best explains the link the service rendered and its cost pool.[26]

As shown in Table 4 on page 26, there are several possible activity drivers for specific types of costs.

3.3 Industry Practice

[Modified - Page 25: lines 16-17 and 20-30]

According to the evidence submitted in its 2013 Amended GRA, the cost allocation methods used by Hydro are purportedly consistent with industry practice as well as industry best practices.[27] Accordingly, I considered the guidance provided by the internal costing practices of other regulated Canadian energy companies to develop my evaluation framework. In particular, I relied, in part, on publicly available documentation regarding the manner in which energy companies across Canada allocated shared services. The following eight energy companies were surveyed:

- ATCO Electric Ltd.;
- BC Hydro;
- Manitoba Hydro;
- New Brunswick Power Corporation;
- Nova Scotia Power Inc.;
- Hydro One;
- Maritime Electric; and
- SaskPower.[28]

The shared services cost allocation methods used by these energy companies are quite similar. Shared service expenses are generally organized into cost pools, which are then allocated to the service recipients using a cost driver(s) based on the cost causation principle.

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24 See SMAC, page 13.
25 See Horngren, page 179.
26 See Bragg, page 303.
27 See Hydro's 2013 Amended GRA, Section 3, page 3.39.
28 See Appendix B for a description of the cost allocation methods currently employed by these regulated Canadian energy companies.

Table 4
Activity-Based Costing
Activity Drivers for Specific Types of Costs

Cost Type	Related Activity Driver
Accounting costs	Number of billings
Accounting costs	Number of cash receipts
Accounting costs	Number of check payments
Accounting costs	Number of general ledger entries
Accounting costs	Number of reports issued
Administration costs	Hours charged to lawsuits
Administration costs	Number of stockholder contacts
Engineering costs	Hours charged to design work
Engineering costs	Hours charged to process planning
Engineering costs	Hours charged to tool design
Engineering costs	Number of engineering change orders
Facility costs	Amount of space utilization
Human resources costs	Employee headcount
Human resources costs	Number of benefits changes
Human resources costs	Number of insurance claims
Human resources costs	Number of pension changes
Human resources costs	Number of recruiting contacts
Human resources costs	Number of training hours
Manufacturing costs	Number of direct labor hours
Manufacturing costs	Number of field support visits
Manufacturing costs	Number of jobs scheduled
Manufacturing costs	Number of machine hours
Manufacturing costs	Number of machine setups
Manufacturing costs	Number of maintenance work orders
Manufacturing costs	Number of parts in product
Manufacturing costs	Number of parts in stock
Manufacturing costs	Number of price negotiations
Manufacturing costs	Number of purchase orders
Manufacturing costs	Number of scheduling changes
Manufacturing costs	Number of shipments
Marketing and sales costs	Number of customer service contacts
Marketing and sales costs	Number of orders processed
Marketing and sales costs	Number of sales contacts made
Quality control costs	Number of inspections
Quality control costs	Number of supplier reviews
Storage time (*e.g.*, depreciation, taxes)	Inventory turnover
Storage transactions (*e.g.*, receiving)	Number of times handled

Source: Bragg, Exhibit 8.2, page 203.

3.4 Tax Administration Guidance

[Modified - Page 27: lines 18-24]

Finally, I considered the guidance provided by the Organisation for Economic Cooperation and Development ("OECD"), the Canada Revenue Agency ("CRA") and other tax administrators around the world to develop my evaluation framework. As described earlier in Section 2.1, when related companies transact with each other, the potential exists for the related companies to determine and use a price that can disadvantage one party over the other but, on the whole, generates a net benefit for the corporate group. This situation is a critical issue for tax administrators worldwide. Intercompany transfer pricing lies at the core of concerns expressed by tax administrators regarding the ability of multinational companies to reduce their effective corporate tax rate through the use of inappropriate transfer prices. Although the affiliate transactions involving Hydro do not transpire across international borders, there exists the potential for the parties to determine and use a transfer price for shared services that might affect the rate at which users pay for electricity in the Province.[29]

Accordingly, I relied, in part, on the following sources to develop my evaluation framework:

- The OECD's Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators("OECD's Transfer Pricing Guidelines"),
- The OECD's Public Discussion Draft, BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services ("OECD BEPS Discussion Draft"),
- The CRA's Information Circular 87-2R International Transfer Pricing ("IC 87-2R"),
- The CRA's Transfer Pricing Memorandum 15, Intra-group services and 247 of the Income Tax Act (the "Act"), and
- Internal Revenue Service's ("IRS") Internal Revenue Code §1.482-9.

3.4.1 The Organisation for Economic Cooperation and Development and Arm's Length Principle

[Modified - Page 27 lines 27-28 and 30; page 28: lines 11, 20-21 and 27-28; page29: lines 2-3, 13-17 and 26-32; page 30: lines, 2, 5-6, 10-11 and 17-34; page 31: lines 21-22 and 27]

The OECD is an international economic organization that promotes economic development and world trade by providing a platform for its 34 member states to compare policy experiences, seeks answers to common problems, identifies good practices, and coordinates domestic and international policies.

The OECD's Committee on Fiscal Affairs provides guidance regarding international standards on taxation, including transfer pricing. In the OECD's Transfer Pricing Guidelines, the OECD endorses the arm's length principle.[30] The arm's length principle requires that the prices and the terms and conditions agreed to between related parties in their commercial transactions be the same as expected had the parties been dealing at arm's length.

The arm's length principle is the internationally accepted norm for evaluating the reasonableness of the prices used for cross-border inter-company transactions. It is also endorsed by the United Nations.[31] As a member of the OECD and the United Nations, the Government of Canada and its tax administrator, the CRA, also endorse the

[29] See Appendix C for detailed tax administration guidance.
[30] See "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators," OECD and "Model Convention Tax Convention on Income and on Capital," July 17, 2008, Chapter III.
[31] "See United Nations Practical Manual on Transfer Pricing for Developing Countries.

arm's length principle. Given that its provincial corporate tax rules rely on the federal rules, the Province of Newfoundland and Labrador indirectly endorses the arm's length principle.[32]

Accordingly, where a charge for a service is justified, tax administrators believe that the amount charged for the service should be determined in accordance with the arm's length principle.[33]

According to the OECD, the CRA and the IRS, the primary test to determine whether a specific activity performed by a member of the multinational group for another member is a service for which a charge is justified is "*whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself.*"[34]

If the activity is not one for which an independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered an intra-group service under the arm's length principle.

Activities that ordinarily would be considered intra-group services can include:

- Administrative services;
- Financial services;
- Marketing services; and
- Services in staff matters.[35]

Similarly, an activity would not be considered an intra-group service if:

- It benefits the owner of the controlled group and does not confer a benefit on the recipient ("Shareholder benefits"),[36]
- It duplicates an activity that the recipient has already performed itself or had a third party perform on its behalf;[37] or
- If the benefit results from the recipient's status as a member of a controlled group.[38]

The following are examples of shareholder activity-related costs provided by the OECD:

- Costs related to the legal structure of the parent company itself, such as the parent's shareholder meetings, issuing shares in the parent company, stock exchange listing of the parent company, and costs related to the governance board;
- Costs related to the financial reporting or regulatory requirements of the parent company including the consolidation of the reports;
- Cost of raising funds for the acquisition of an interest in a business;
- Cost related to compliance of the parent company with the relevant tax laws; and
- Costs which are ancillary to the corporate governance of the multinational enterprise as a whole.[39]

[32] Canada's transfer pricing rules are embodied in Section 247 of the ITA. Guidance with respect to the administrative application of those rules by the Canada Revenue Agency is published in IC 87-2R.
[33] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.1, paragraph 7.19 and IC 87-2R, paragraph 159.
[34] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.6. See also OECD BEPS Public Discussion Draft, page 7, IC 87-2R, paragraph 162 and §1.482-9(1)(3)(i)
[35] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.14. See also IC 87-2R, paragraph 162 and §1.482-9(1)(3)(i)
[36] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.9 and OECD BEPS Public Discussion Draft, page 8.
[37] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.11 and OECD BEPS Public Discussion Draft, page 8.
[38] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.13 and OECD BEPS Public Discussion Draft, page 9.

In the absence of transactions between Hydro or one of its affiliates and a third party, or between two third parties, involving the same or similar services rendered by Hydro to its affiliates or by an affiliate to Hydro, which would yield arm's length prices, the OECD and the CRA encourage multinational companies to consider cost recovery-based methods to determine an appropriate cost of a service.

Although there is limited guidance provided by the OECD or the CRA regarding which costs to take into account when determining the cost of rendering a service, the IRS' Internal Revenue Code defines total services cost as "*all costs of rendering those services*."[40] The term "*all costs*" generally includes direct operating costs (*e.g.*, salaries and benefits) as well as indirect operating costs (*e.g.*, overhead), but excludes non-operating costs, such as "*interest expense, foreign income taxes, or domestic income taxes*"[41] as well as "*shareholder costs*."

Once the cost base is determined, taxpayers are then encouraged to identify and remove from the cost base those costs that are attributable to services performed by one group member solely on behalf of one other group member.[42]

The remaining cost base is then allocated to the relevant service recipients to approximate the cost of service to those recipients. The guidance provided by the OECD in its Transfer Pricing Guidelines is limited. It states the allocation can be based on "*turnover, or staff employed, or some other basis*." [43] The guidance provided by the CRA is also limited to the following:

> "*When choosing an allocator (e.g., sales, gross or operation profits, units used/produced/sold, number of employees, or capital invested), the taxpayer should consider the nature and use made of the service*."[44]

Even the IRS provides limited guidance to taxpayers in terms of an appropriate allocation method.

> "*Any reasonable method may be used to allocate and apportion costs. In establishing the appropriate method of allocation and apportionment, consideration should be given to all bases and factors, including, for example, total services costs, total costs for a relevant activity, assets, sales, compensation, space utilized, and time spent*."[45]

In the OECD BEPS Discussion Draft, the taxpayers are encouraged to select an allocation key that reflects the level of benefit expected to be received by each service recipient for each category of services rendered.[46] As a general rule the allocation key should reflect the underlying need for the particular service rendered. For example, the allocation key for services related to people might use each company's share of total group headcount; IT services might use the share of total users, fleet management services might use the share of total vehicles, accounting support services might use the share of total relevant transactions of share of assets. In other cases, the share of total sales may be the most relevant key.

To augment this limited guidance, I surveyed member firms of Grant Thornton to gain an understanding of the cost allocation methods used to allocate centralized services within multinational companies in 80 countries.[47] The results indicate that 70 of the 80 countries that participated in the survey generally follow the OECD Transfer

[39] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.10 and OECD BEPS Public Discussion Draft, page 8. See also IC 87-2R, paragraphs 156 and 157, and §1.482-9(l).
[40] See §1.482-9(j).
[41] See §1.482-9(j).
[42] See OECD BEPS Discussion Draft, page 18.
[43] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.3,paragraph 7.25.
[44] See OECD Transfer Pricing Guidelines, Chapter VII, Section A, paragraph 7.2.
[45] See §1.482-9(k).
[46] See OECD BEPS Discussion Draft, page 18.
[47] See Appendix D for a comprehensive list of the responses from each country.

Pricing Guidelines or the arm's length principle. Of the remaining ten countries, four do not have transfer pricing legislation and the remaining six countries base their transfer pricing methods on the following factors:

- The nature of the service, which is analogous to the OECD's Transfer Pricing Guidelines;
- Gross income or net sales, which is consistent with the examples provided by Canada, France, Germany, and United States;
- Fair market value, which is embodied by the arm's length principle; and
- Staff numbers and asset size, which is consistent with the examples provided by the OECD's Transfer Pricing Guidelines.

Once the cost of rendering a service has been determined, multinational companies must determine whether that cost of service should be marked-up, and if so, by how much. Although arm's length service providers would normally seek to charge a fee for their service that generates a profit, there are circumstances in which an arm's length party would not generate a profit from rendering a service.

In the context of multinational companies, tax administrators consider the value of the service being rendered to determine whether a cost of service should be marked-up. In general, tax administrators have historically permitted mark-ups on value-added activities and denied mark-ups on routine activities. This has been a contentious issue amongst tax administrators. In the OECD BEPS Discussion Draft, the OECD has proposed a simplified approach to for determining the amount to be charged and paid for by individual members of a multinational enterprise for low value-adding services based on the costs incurred to render the service plus a mark-up between 2 percent to 5 percent. The services identified by the OECD that would likely meet the definition of low value-adding services included:

- Accounting and audit activities;
- Processing and management of accounts receivable and accounts payable;
- HR activities;
- Monitoring and compiling date related to health, safety environmental and other standards regulating the business;
- Information technology services, that are not part of the principal activity of the group;
- Internal and external communications and public relations support, excluding specific advertising and marketing activities;
- Legal services;
- Tax activities; and
- Administration support

Whether the common services rendered by Hydro or the corporate services rendered by its affiliates for Hydro and by Hydro for its affiliates might be marked up depends on the specific service rendered. For example, the safety and health, and IS-related services rendered by Hydro are services that, in my experience, would normally be marked-up because they require engineering and IT skills to perform these functions. Alternatively, the HR-related services rendered by Hydro are services that would not normally be marked-up. The common expenses and other expenses charged by Hydro to its affiliates would normally be treated as flow through costs and charged back without a mark-up. Whether a mark-up on a service is permitted by a tax administrator will also depend on the interaction of other intercompany transactions involving the related parties. Ultimately, from a transfer pricing perspective, a mark-up will or will not be permitted to the extent that it facilitates the accurate and reliable calculation of taxable income.

Nalcor and Hydro are provincial crown corporations and are not subject to tax. Consequently, relying on the tax implications for guidance on this matter would be ineffective. Alternatively, I considered whether the absence on a mark-up would create an inappropriate subsidy. First, I considered the implications of Nalcor marking up the costs of rendering certain corporate services to Hydro. Such a mark-up would increase Hydro's revenue requirements and the rates that it charges its customers. Accordingly, I believe that applying a mark-up to the costs of rendering corporate services to Hydro would be inappropriate.

I believe that the same answer applies to situations in which Hydro is providing common or corporate services for the benefit of the public energy projects of its affiliates. To do otherwise, would create a situation in which Hydro's revenue requirement would decline at the expense of Nalcor, one of the public energy projects of its other lines of business or the Province. However, not all of Nalcor's energy projects are entirely publicly owned; some of its energy projects are partially owned by other provincial governments or private interests. In the context of energy projects involving private interests, the absence of a mark-up on the costs of rendering common services or corporate services for the direct benefit of these private energy projects would lower the amounts charged for such services and increase the profits generated by these projects to the benefit of private interests. This outcome would create an inappropriate subsidy at the expense of Hydro and its customers. Accordingly, I believe that should Hydro render services to Nalcor or one of its other lines of business for the benefit of an energy project involving private interests, the costs of rendering such services should be marked-up by an arm's length amount, between two percent and five percent as proposed by the OECD.

Whether or not Hydro or its affiliates apply a mark-up to the costs incurred rendering intercompany services should be considered from the perspective of materiality and practicality. Based on an analysis that I will present in Section 5, marking-up the costs to be recovered by Hydro from its affiliates, or vice versa, for rendering common or corporate services would not be material. Accordingly, the efforts to determine the magnitude of, and administer and monitor any such mark-up beyond simply relying on the mark-up proposed by the OECD might not be practical.

3.5 Evaluation Framework

[Unchanged]

I developed the following evaluation framework based on my past experience, the managerial accounting literature, industry practice, and tax administrator guidance described above:

- A service must be rendered and justified;
- Where rendered and justified, the amount charged for the service should be consistent with the arm's length principle;
- In the absence of arm's length prices, the transfer price for services rendered to and by an affiliate should be determined using a cost recovery method;
- Where the services have been rendered to an identifiable affiliate and the costs can be reasonably quantified, the direct charge method should be used to determine the amount charged for services rendered to and by an affiliate;
- Where the services have been rendered to a number of affiliates and the portion of the value of the service directly attributable to each affiliate cannot be determined, the indirect charge method should be used to determine the amount charged for the services rendered to and by an affiliate;
- The costs to be recovered should include all operating expenses incurred to render the services to an affiliate, including depreciation, but excluding interest;

- When allocating the costs to be recovered amongst a group of affiliates, the allocator should have a causal relationship with the service rendered; and
- Unless the ultimate recipient of the service rendered is an energy project involving private interests, no mark-up should be applied to the costs to be recovered.

4 Evaluating the Affiliate Transactions

4.1 Overview

[Unchanged]

I evaluated the following affiliate transactions involving Hydro based on the evaluation framework I presented in Section 3.5:

- Common services rendered by Hydro to its affiliates;
- Common expenses incurred by Hydro and charged out to its affiliates;
- Other expenses incurred by Hydro and charged out to its affiliates; and
- Corporate services rendered by affiliates to Hydro and by Hydro to its affiliates.

4.2 Common Services Rendered by Newfoundland and Labrador Hydro

[Unchanged]

As described in Section 2.4.1, Hydro renders the following common services to Nalcor and its other lines of business:

- HR;
- Safety and Health; and
- IS.

4.2.1 Human Resources

4.2.1.1 Determining Whether a Service had been Rendered

[Unchanged]

Evidence describing the HR-related services rendered by Hydro for its affiliates was presented in Section 2.4.1.1 and Section 2.5.5 of this report. Based on this evidence, I have concluded the following:

- These services would ordinarily be considered intra-group services;
- The affiliates derive value from the HR-related services rendered by Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activity on its own behalf in-house; and
- Hydro renders HR-related services to its affiliates for which an arm's length price should be charged.

4.2.1.2 Determining an Arm's Length Price

[Modified - Page 34: lines 1-5, 7, and Table 5; page 35: lines 2-7, 12 and Table 6; and page 37: lines 3, 5, 9-10, 14-15, and 17-19]

Hydro determines the amount charged to each affiliate for which it renders HR-related services based on an indirect cost recovery method, without applying a mark-up to the costs.

As shown in Table 5, Hydro determined its costs to be recovered for rendering HR-related services to be $1.9 million during 2013. Most of these costs related to salaries and fringe benefits for those employed in the HR department or for miscellaneous expenses. Hydro expects its HR-related costs to be recovered to increase by 4.0 percent during the 2014 and 2015 test years, respectively.

Hydro's calculation of the HR-related costs to be recovered starts with its HR department's operating costs which include costs for salaries and fringe benefits, system equipment maintenance, office supplies, professional services, equipment rental costs, travel and miscellaneous expenses. Hydro then excludes payroll taxes, which are included in miscellaneous expenses, recharges for corporate services rendered and advertising costs initially borne by Hydro that will then be charged back to Nalcor as an other expense.

Table 5
Newfoundland and Labrador Hydro
Human Resources
Costs to be Recovered
December 31, 2011-2015
CAD 000s

	2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
Itemized Listing of Operating Costs					
Salaries & Fringe Benefits	1,044.9	1,356.0	1,597.6	1,492.4	1,688.3
System Equipment Maintenance	22.0	20.6	16.5	28.0	28.7
Office Supplies & Expenses	41.1	38.6	33.2	38.4	37.3
Professional Services	192.1	171.5	86.7	211.2	200.0
Equipment Rentals	0.0	N/R	0.2	2.0	2.1
Travel	24.4	33.6	36.1	35.0	46.8
Miscellaneous Expenses	1,606.2	1,598.7	1,739.0	1,722.5	1,765.5
Building Rental & Maintenance	0.1	0.2	0.2	N/R	N/R
Total Operating Costs	**2,930.8**	**3,219.1**	**3,509.5**	**3,529.5**	**3,768.7**
Determination of Common Service Costs					
Recharged salaries	(63.2)	(78.0)	(128.1)	(83.4)	(116.3)
Advertising	N/R	N/R	(27.4)	(25.0)	(25.6)
Payroll tax	(1,401.7)	(1,453.6)	(1,558.4)	(1,554.0)	(1,592.8)
Total	**1,465.9**	**1,687.5**	**1,795.6**	**1,867.0**	**2,033.9**

Source: Hydro's 2013 Amended GRA, PUB-NLH-176-R1, page 1.
Note: Numbers might not add due to rounding.

The HR-related costs to be recovered are allocated based on FTEs.

As shown in Table 6, Hydro charged its affiliates roughly $0.7 million through the Administration Fee for HR-related services rendered during 2013. By charging back these costs to its affiliates through the Administration Fee, Hydro recovered roughly 36.3 percent of its HR-related costs. Hydro expects to recover 38.8 percent of its future HR-related costs from its affiliates through the Administration Fee during the 2014 test year and 38.5 percent during the 2015 test year. There is no indication in the evidence provided to identify which of Nalcor's other lines of business were the recipient of Hydro's HR-related services.[48]

Table 6
Newfoundland and Labrador Hydro
Human Resources
Costs Allocated to Nalcor Energy's Other Lines of Business
December 31, 2011-2015
CAD 000s

		2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
A	Costs allocated	1,465.9	1,687.5	1,795.6	1,867.0	2,033.9
	Allocator (FTEs)					
B	Hydro Regulated	827.6	813.7	815.4	887.8	954.9
C	Other lines of business	462.6	493.0	518.9	604.5	655.4
D	**Total**	**1,290.2**	**1,306.7**	**1,334.3**	**1,492.3**	**1,610.3**
E	Cost per FTE (A/D)	1.1	1.3	1.3	1.3	1.3
	Allocations					
F	Hydro Regulated (B*E)	940.3	1,050.8	1,097.3	1,110.7	1,206.1
G	Other lines of business (C*E)	525.6	636.7	698.3	756.3	827.8
	Total	**1,465.9**	**1,687.5**	**1,795.6**	**1,867.0**	**2,033.9**

Source: Hydro's 2013 Amended GRA, PUB-NLH-176-R1, page 1.
Note: Numbers might not add due to rounding.

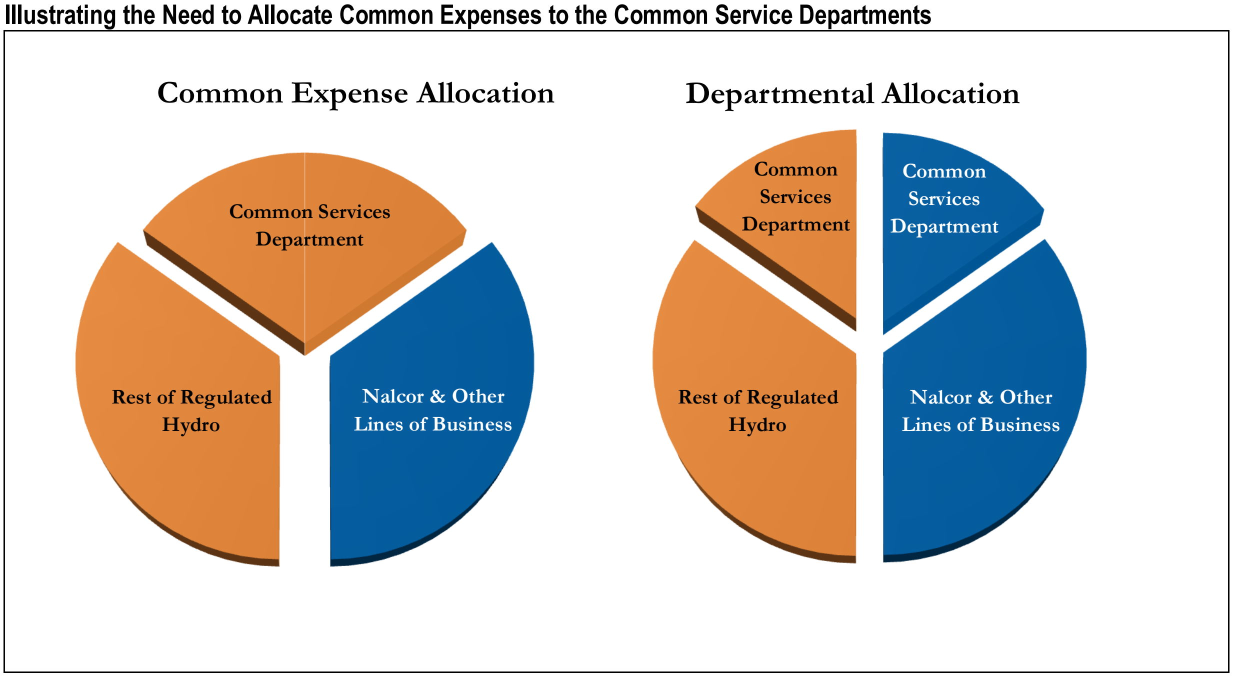
Although Hydro incurs professional HR-related services, there is no indication in the evidence that Hydro engages third parties to render any of the same HR-related services it renders to its affiliates. Nor is there any indication in the evidence that the affiliates engage third parties to render any of the same HR-related services Hydro renders to them. It is also likely that any such market data would include an unidentifiable profit element. Accordingly, there is no evidence that there are internal comparable uncontrolled transactions which could be used to determine an arm's length price using a comparable price method.

[48] Hydro stated in PUB-NLH-416 that identifying which of Nalcor's other lines of business were the recipients of Hydro's IS-related services was not warranted for an understanding and assessment of the issues before the Board.

There are two potential issues to consider regarding the inclusion of payroll taxes in the HR department's miscellaneous expenses line item. First, Hydro's HR department is responsible for administrating payroll-related activities for all of Nalcor's lines of business. As a result, it should be confirmed that these payroll taxes are attributed to Hydro employees and not employees of Nalcor or one its other lines of business. There is no indication in the evidence describing these payroll taxes or whether they have been properly allocated to the appropriate affiliate, if necessary. Second, if these payroll expenses are attributable to Hydro employees, then it should be confirmed that any portion of these payroll taxes attributable to the HR department is accounted for in its costs to be recovered.

There might also be an issue with the way in which Hydro allocates the common expenses. Although Hydro allocates common expenses amongst Nalcor's lines of business, there is no indication in the evidence that Hydro included in its HR-related costs to be recovered an amount accounting for the HR department's share of common expenses. To illustrate my point, consider Exhibit 8. The diagram on the left, entitled Common Expense Allocation, represents the allocation of the common expenses between Hydro and its affiliates. To ensure that the charges for the common services rendered by Hydro to its affiliates are fully burdened, Hydro's share of the common expenses need to be appropriately allocated to each of the departments within Hydro that are providing these common services: the HR department, the Safety and Health department and the IS department. In the absence of this internal allocation of Hydro's share of common expenses, the costs to be recovered for rendering these common services might not be fully burdened and, as a result, the charge for such services by Hydro to its affiliates might be understated. The diagram on the right in Exhibit 8, entitled Departmental Allocation, illustrates the effective allocation of the common expenses after the departments within Hydro providing common services have included their share of common expenses in the costs to be recovered.

Exhibit 8
Illustrating the Need to Allocate Common Expenses to the Common Service Departments



Note: This exhibit is not to scale.

Regarding the potential that Hydro might not have included the HR department's share of common expenses in its HR-related costs to be recovered, I have estimated the amount potentially excluded from this cost base to be $173,800 based on the 2015 test year. Nalcor's other lines of business account for roughly 40.7 percent of the FTEs used to allocate Hydro's HR-related costs to be recovered. Consequently, the potential understatement of HR-related charges to Hydro's affiliates might be less than $70,700. Based on an analysis I present in Section 5, a potential increase of this magnitude in the amounts to be charged by Hydro to its affiliates for rendering HR-related services would not be material.

Based on this evidence, I have concluded the following:

- Allocating the costs of HR-related services rendered by Hydro to its affiliates using an indirect cost recovery method is reasonable. It would not be practical for Hydro to conduct the research required to determine a direct charge for such services based on market data;
- Further disclosure is warranted regarding Hydro's treatment of the payroll taxes reported in the HR department's operating costs;
- The HR-related costs to be recovered through the Administration Fee might not be fully-burdened and, as a result, the amount charged by Hydro to its affiliates for this common service might be understated;
- Allocating the HR-related costs to be recovered based on FTEs is reasonable; and
- Unless the ultimate recipient of the HR-related services is an energy project involving private interests, not marking-up the HR-related costs to be recovered is reasonable. Otherwise, the costs should be mark-up by at least two percent to five percent.

4.2.2 Safety and Health

4.2.2.1 Determining Whether a Service had been Rendered

[Unchanged]

Evidence describing the safety and health-related services rendered by Hydro for its affiliates was presented in Section 2.4.1.2 and Section 2.5.6 of this report. Based on this evidence, I have concluded the following:

- These services would ordinarily be considered intra-group services;
- The affiliates derive value from the safety and health-related services rendered by Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activity on its own behalf in-house; and
- Hydro renders safety and health-related services to its affiliates for which an arm's length price should be charged.

4.2.2.2 Determining an Arm's Length Price

[Modified - Page 38: lines 1-8 and Table 7; page 39: lines 1-10 and Table 8; page 40: lines 9-12 and 24]

Hydro determines the amount charged to each affiliate for which it renders safety and health-related services based on an indirect cost recovery method, without applying a mark-up to the costs.

As shown in Table 7, Hydro determined its costs to be recovered for rendering safety and health-related services to be about $1.1 million during 2013.[49] Most of these expenses are for salaries and fringe benefits for those employed in the Safety and Health department or for professional services.Hydro expects its safety and health-related costs to be recovered to decrease by 4.2 percent during the 2014 test year and then increase by 7.7 percent during the 2015 test year.

Hydro's calculation of the safety and health-related costs to be recovered starts with its Safety and Health department's operating costs which include the same expenses itemized in the HR department's operating costs plus building rental and maintenance. Hydro then excludes recharges for corporate services rendered by Hydro.

Table 7
Newfoundland and Labrador Hydro
Safety and Health
Costs to be Recovered
December 31, 2011-2015
CAD 000s

	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Test Year)	2015 (Test Year)
Itemized Listing of Operating Costs					
Salaries & Fringe benefits	620.9	707.9	657.2	630.9	611.6
System Equipment Maintenance	10.9	7.1	14.5	44.5	45.6
Office Supplies & Expenses	32.6	36.2	32.8	34.3	35.6
Professional Services	211.1	169.3	245.4	243.2	303.0
Equipment Rentals	0.3	0.0	0.1	1.0	1.0
Travel	37.9	51.6	41.3	45.8	49.4
Miscellaneous Expenses	3.5	2.8	4.5	4.6	4.7
Building Rental & Maintenance	86.8	95.7	128.0	89.7	91.9
Total Operating Costs	**1,004.0**	**1,070.6**	**1,123.8**	**1,093.9**	**1,142.9**
Determination of Common Service Costs					
Recharged salaries	(67.5)	(105.1)	(99.3)	(112.5)	(85.5)
Total	**936.5**	**965.5**	**1,024.5**	**981.4**	**1,057.4**

Source: Hydro's 2013 Amended GRA, PUB-NLH-184-R1, page 1.
Note: Numbers might not add due to rounding.

The safety and health-related costs to be recovered are allocated based on FTEs.

[49]There is no indication in the evidence to explain why the Cost Recoveries are not the same as the Add Back Cost Recoveries for Administration Fee. The Total amounts in Table 7 do not include Cost Recoveries and Add Back Cost Recoveries for Administration Fee as detailed in Hydro's 2013 Amended GRA, PUB-NLH-184. These amounts should net to zero, however, in 2011, 2012, and 2013 there is a difference of $35,457, $41,750 and $47,241, respectively. The Total amounts in Table 8 are those reported in Hydro's 2013 Amended GRA, PUB-NLH-184 - R1.

As shown in Table 8, Hydro charged its affiliates roughly $0.4 million through the Administration Fee for safety and health-related services rendered during 2013. By charging back these costs to its affiliates through the Administration Fee, Hydro recovered roughly 34.4 percent of its safety and health-related costs. Hydro expects to recover 36.3 percent of its future safety and health-related costs from its affiliates through the Administration Fee during the 2014 test year and 37.7 percent during the 2015 test year. Hydro also recovered roughly $30,900 of its safety and health-related costs from external cost recoveries during 2013. It did not identify from which external entities it recovered these costs. Hydro has not included any external costs recoveries in its 2014 and 2015 test year data.[50]

Table 8
Newfoundland and Labrador Hydro
Safety and Health
Costs Allocated to Nalcor Energy's Other Lines of Business
December 31, 2011-2015
CAD 000s

		2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Test Year)	2015 (Test Year)
A	Costs allocated	901.0	923.7	993.6	981.4	1,057.4
	Allocator (FTEs)					
B	Hydro Regulated	827.6	813.7	815.4	887.8	954.9
C	Other lines of business	462.6	493.0	518.9	604.5	655.4
b	**Total**	**1,290.2**	**1,306.7**	**1,334.3**	**1,492.3**	**1,610.3**
E	Cost per FTE (A/D)	0.7	0.7	0.7	0.7	0.7
	Allocations					
F	Hydro Regulated (B*E)	578.0	575.2	607.2	583.9	627.0
G	Other lines of business (C*E)	323.1	348.5	386.4	397.6	430.4
	Total	**901.0**	**923.7**	**993.6**	**981.4**	**1,057.4**

Source: Hydro's 2013 Amended GRA, PUB-NLH-184-R1, page 1.
Note: Numbers might not add due to rounding.

There is no indication in the evidence provided to identify which of Nalcor's other lines of business were the recipient of Hydro's safety and health-related services.[51]

[50] See Hydro's 2013 Amended GRA, PUB-NLH-184 - R1 and PUB-NLH-481.
[51] Hydro stated in PUB-NLH-416 that identifying which of Nalcor's other lines of business were the recipients of Hydro's IS-related services was not warranted for an understanding and assessment of the issues before the Board.

Although Hydro incurs professional safety and health-related services, there is no indication in the evidence that Hydro engages third parties to render any of the same safety and health-related services it renders to its affiliates. Nor is there any indication in the evidence that the affiliates engage third parties to render any of the same safety and health-related services Hydro renders to them. It is also likely that any such market data would include an unidentified profit element. Accordingly, there is no evidence that there are internal comparable uncontrolled transactions upon which to determine an arm's length price using a comparable price method.

Regarding the potential that Hydro might not have included the Safety and Health department's share of common expenses in its safety and health-related costs to be recovered, I have estimated the amount potentially excluded from this cost base to be $45,000 based on the 2015 test year. Nalcor's other lines of business account for roughly 40.7 percent of the FTEs used to allocate Hydro's safety and health-related costs to be recovered. Consequently, the potential understatement of safety and health-related charges to Hydro's affiliates might be less than $18,300. Based on an analysis I present in Section 5, a potential increase of this magnitude in the amounts to be charged by Hydro to its affiliates for rendering safety and health-related services would not be material.

Based on this evidence, I have concluded the following:

- Allocating the safety and health-related services rendered by Hydro to its affiliates using an indirect cost recovery method is reasonable. It would not be practical for Hydro to conduct research to determine a direct charge for such services based on market data;
- The safety and health-related cost to be recovered through the Administration Fee might not be fully-burdened and, as a result, the amount to be charged by Hydro to its affiliates for this common service might be understated;
- Allocating the safety and health-related costs to be recovered based on FTEs is reasonable; and
- Unless the ultimate recipient of Hydro's safety and health-related services is an energy project involving private interests, not marking-up the safety and health-related costs to be recovered is reasonable. Otherwise, the costs should be mark-up by at least two percent to five percent.

4.2.3 Information Systems

4.2.3.1 Determining Whether a Service had been Rendered

[Unchanged]

Evidence describing the IS-related services provided by Hydro was presented in Section 2.4.1.3 of this report. Based on this evidence, I have concluded the following:

- These services would ordinarily be considered intra-group services;
- The affiliates derive value from the IS-related services rendered by Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activity on its own behalf in-house; and
- Hydro renders IS-related services to its affiliates for which an arm's length price should be charged.

4.2.3.2 Determining an Arm's Length Price

[Modified - Page 41: lines 1-2, 7-11, and Table 9; page 42: lines 2-5, 6-7 and Table 10; and page 43: lines 3-5 and 16-17]

Hydro determines the amount charged to each affiliate for which it renders IS-related services based on an indirect cost recovery method, without applying a mark-up to the costs.

As shown in Table 9, Hydro determined its costs to be recovered for rendering IS-related to be $6.6 million during 2013. Most of these expenses are for salaries and fringe benefits for those employed in the IS department or for professional services. Depreciation expense and a return on rate base at the WACC for costs capitalized such as servers and software are included in the cost base. Costs that are incurred solely for a particular line of business are charged to that line of business and are excluded from the determination of shared costs (*i.e.*, software maintenance costs).

Hydro's calculation of the IS-related costs to be recovered starts with the IS department's operating costs which include the same expenses itemized in the Safety and Health department's operating costs. Hydro then adds depreciation and a return on rate base for capitalized costs and excludes recharges for corporate services rendered and software maintenance costs initially borne by Hydro that will then be charged back to Nalcor or one of its lines of business as another expense.

Table 9
Newfoundland and Labrador Hydro
Information Systems
Costs to be Recovered
December 31, 2011-2015
CAD 000s

	2011 *(Actual)*	2012 *(Actual)*	2013 *(Actual)*	2014 *(Test Year)*	2015 *(Test Year)*
Itemized Listing of Operating Costs					
Salaries & Fringe Benefits	3,439.1	3,504.7	3,596.7	4,000.9	3,811.1
System Equipment Maintenance	296.7	274.2	402.3	312.2	320.0
Office Supplies & Expenses	114.0	132.6	177.6	163.1	167.2
Professional Services	1,227.7	1,460.4	1,357.9	1,505.1	1,549.6
Equipment Rentals	96.9	102.4	114.6	109.3	112.1
Travel	49.9	62.1	43.7	103.7	106.3
Miscellaneous Expenses	4.5	10.8	12.1	8.1	8.3
Building Rental & Maintenance	0.3	0.4	0.6	1.1	1.1
Total Operating Costs	**5,229.1**	**5,547.5**	**5,705.6**	**6,203.6**	**6,075.8**
Determination of Common Service Costs					
Depreciation and return on rate base on common assets		1,828.3	1,193.9	735.2	625.8
Recharged salaries	(8.2)	(4.5)	(5.4)	(4.8)	(5.0)
Software Maintenance Costs	(256.6)	(386.6)	(328.9)	(326.6)	(323.7)
Total	**4,964.3**	**6,984.7**	**6,565.2**	**6,607.4**	**6,372.9**

Source: Hydro's 2013 Amended GRA, PUB-NLH-192-R1, page 1.
Note: Numbers might not add due to rounding.

The IS-related costs to be recovered are allocated based on an average user basis.

As shown in Table 10, Hydro charged its affiliates roughly $2.8 million through the Administration Fee for IS-related services rendered during 2013. By charging back these costs to its affiliates through the Administration Fee, Hydro recovered roughly 40.8 percent of its IS-related costs. Hydro expects to recover 37.0 percent of its future IS-related costs from its affiliates through the Administration Fee during the 2014 test year and 43.9 during the

Table 10
Newfoundland and Labrador Hydro
Information Systems
Costs Allocated to Nalcor Energy's Other Lines of Business
December 31, 2011-2015
CAD 000s

		2011 *(Actual)*	2012 *(Actual)*	2013 *(Actual)*	2014 *(Test Year)*	2015 *(Test Year)*
A	Costs allocated	4,964.3	6,984.7	6,565.2	6,607.4	6,372.9
	Allocator (Average User)					
B	Hydro Regulated	872.4	912.7	928.1	926.5	1,020.1
C	Other lines of business	463.4	511.0	696.2	589.1	875.8
b	**Total**	**1,335.8**	**1,423.7**	**1,624.3**	**1,515.6**	**1,895.9**
E	Cost per FTE (A/D)	3.7	4.9	4.0	4.4	3.4
	Allocations					
F	Hydro Regulated (B*E)	3,242.2	4,477.7	3,751.3	4,039.1	3,429.0
G	Other lines of business (C*E)	1,722.2	2,507.0	2,814.0	2,568.2	2,943.9
	Total	**4,964.3**	**6,984.7**	**6,565.2**	**6,607.4**	**6,372.9**

Source: Hydro's 2013 Amended GRA, PUB-NLH-192-R1, page 1.
Note: Numbers might not add due to rounding.

2015 test year. There is no indication in the evidence provided to identify which of Nalcor's other lines of business were the recipient of Hydro's IS-related services.[52]

Although Hydro incurs professional IS-related services, there is no indication in the evidence that Hydro engages third parties to render any of the same IS-related services it renders to its affiliates. Nor is there any indication in the evidence that the affiliates engage third parties to render any of the same IS-related Hydro renders to them. It is also likely that any such market data would include an unidentified profit element. Accordingly, there is no evidence that there are internal comparable uncontrolled transactions upon which to determine an arm's length price using a comparable price method.

[52] Hydro stated in PUB-NLH-416 that identifying which of Nalcor's other lines of business were the recipients of Hydro's IS-related services was not warranted for an understanding and assessment of the issues before the Board.

Regarding the potential that Hydro might not have included the IS department's share of common expenses in its IS-related costs to be recovered, I have estimated the amount potentially excluded from this cost base to be $370,000 based on the 2015 test year. Nalcor's other lines of business account for roughly 46.2 percent of the FTEs used to allocate Hydro's IS-related costs to be recovered. Consequently, the potential understatement of IS-related charges to Hydro's affiliates might be less than $171,000. Based on an analysis I present in Section 5, a potential increase of this magnitude in the amounts to be charged by Hydro to its affiliates for rendering IS-related services would not be material.

Based on this evidence, I have concluded the following:

- It is reasonable for Hydro to use an indirect charge method to determine an arm's length price for the IS-related services it renders to its affiliates. It would not be practical for Hydro to conduct research to determine a direct charge for such services based on market data;
- The IS-related cost to be recovered through the Administration Fee might not be fully-burdened and, as a result, the amount to be charged by Hydro to its affiliates for this common service might be understated;
- Allocating the IS-related costs to be recovered based on average users is reasonable; and
- Unless the ultimate recipient of Hydro's IS-related services is in an energy project involving private interests, not marking-up the IS-related costs to be recovered is reasonable. Otherwise, the costs should be mark-up by at least two percent to five percent.

4.3 Common Expenses Charged Out by Newfoundland and Labrador Hydro

[Unchanged]

As described in Section 2.4.2, Hydro charges out the following common expenses to Nalcor and its other business lines:

- Office space;
- Telephone infrastructure, including the LAN; and
- Other expenses not covered by the Administration Fee.

4.3.1 Office Space

4.3.1.1 Determining Whether a Service had been Rendered

[Unchanged]

Evidence that Nalcor's other lines of business occupy Hydro's office space was presented in Section 2.4.2.1. Based on this evidence, I have concluded the following:

- The affiliates derive value from occupying the office space at Hydro Place and would have been willing to pay for this office space had it been provided by an independent enterprise, or would have leased alternative office space owned by an independent enterprise on its own behalf; and
- Hydro provides office space to its affiliates for which an arm's length price should be charged.

4.3.1.2 Determining an Arm's Length Price

[Modified - Page 44: lines 1-2, 12 and Table 11; and page 45: lines 1-5, 8-10, and Table 12]

Hydro determines the amount charged to each affiliate for the office floor space occupied at Hydro Place based on an indirect cost recovery method, without marking up the costs.

As shown in Table 11, Hydro determined its building rental costs at Hydro Place to be roughly $4.0 million during 2013. Most of these expenses are for salaries and fringe benefits, system equipment maintenance, and depreciation expense and a return on rate base at the WACC for capitalized common assets costs shown in the accounts as interest.

The common assets depreciated in this cost recovery model include:

- Furniture for offices, cubicles and common areas;
- Fitness equipment;
- Cafeteria equipment;
- Printers and fax machines;
- Mailroom equipment; and
- Network services equipment.

Table 11
Newfoundland and Labrador Hydro
Building Rental Costs
December 31, 2011-2015
CAD 000s

	2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
Itemized Listing of Operating Costs					
Salaries & Fringe benefits	1,011.1	854.2	959.3	1,006.1	1,014.3
System Equipment Maintenance	875.5	1,026.0	955.6	776.4	865.6
Office Supplies & Expenses	432.2	377.1	442.3	473.2	483.5
Professional Services	N/R	93.7	37.5	80.0	80.0
Travel	N/R	N/R	0.4	N/R	100.0
Miscellaneous Expenses	N/R	N/R	9.3	N/R	N/R
Building Rental & Maintenance	29.5	14.6	8.1	18.0	18.5
Subtotal Operations & Maintenance	**2,348.2**	**2,365.7**	**2,412.5**	**2,353.7**	**2,561.8**
Depreciation and Interest	1,555.4	1,812.7	1,567.4	1,609.6	1,509.7
Total	**3,903.7**	**4,178.4**	**3,979.8**	**3,963.3**	**4,071.6**

Source: Hydro's 2013 Amended GRA, PUB-NLH-200-R1.
Note: Numbers might not add due to rounding.

Hydro's building rental costs are allocated based on the amount of office floor space occupied and a square footage rental rate.

As shown in Table 12, Hydro charged its affiliates roughly $1.6 million for office space at Hydro Place during 2013. By charging back these costs to its affiliates, Hydro recovered roughly 39.5 percent of its office-related costs. Hydro expects its building rental costs to decrease by 0.4 percent during the 2014 test year and then increase by 2.7percent during the 2015 test year. Hydro expects to recover 44.5 percent of its future building rental costs by renting floor space to its affiliates during the 2014 test year and 31.9 percent during the 2015 test year. No evidence was provided to indicate how much floor space was rented by Nalcor and each of its other lines of business.[53]

Table 12
Newfoundland and Labrador Hydro
Building Rental Allocations to Nalcor Energy's Other Lines of Business
December 31, 2011-2015
CAN 000s

		2011 *(Actual)*	2012 *(Actual)*	2013 *(Actual)*	2014 *(Test Year)*	2015 *(Test Year)*
A	Costs allocated	3,903.7	4,178.4	3,979.8	3,963.3	4,071.6
	Allocations (Square Footage)					
B	Hydro Regulated	117.8	86.1	92.3	84.7	103.8
C	Other lines of business	29.3	66.4	60.2	67.8	48.7
b	**Total**	**147.1**	**152.5**	**152.5**	**152.5**	**152.5**
E	Cost per square foot (A/D)	26.5	27.4	26.1	26.0	26.7
	Allocations					
F	Hydro Regulated (B*E)	3,126.2	2,359.3	2,409.9	2,200.6	2,771.9
G	Other lines of business (C*E)	777.5	1,819.1	1,569.9	1,762.7	1,299.7
	Total	**3,903.7**	**4,178.4**	**3,979.8**	**3,963.3**	**4,071.6**

Source: Hydro's 2013 Amended GRA, PUB-NLH-200-R1.
Note: Numbers might not add due to rounding.

Based on this evidence, I have concluded the following:

- The building rental costs are fully burdened and do not include any non-operating expenses;
- Allocating the building rental costs based on floor space occupied as the allocator is reasonable; and
- Treating the building rental costs as flow through costs and changing them back without a mark-up is reasonable.

[53] Hydro stated in PUB-NLH-416 that identifying which of Nalcor's other lines of business were the recipients of Hydro's telephone infrastructure-related costs are not warranted for an understanding and assessment of the issues before the Board.

4.3.2 Telephone Infrastructure

4.3.2.1 Determining Whether a Service had been Rendered

[Unchanged]

Evidence that Nalcor and its other lines of business share in the use of Hydro's telephone infrastructure was presented in Section 2.4.2.2. Based on this evidence, I have concluded the following:

- The affiliates derive value from using Hydro's telephone infrastructure and would have been willing to pay for the use of this telephone infrastructure had they been provided by an independent enterprise, or would have incurred similar costs had they built and maintained a telephone infrastructure for its own behalf; and
- Hydro provides access to telephone infrastructure to its affiliates for which an arm's length price should be charged.

4.3.2.2 Determining an Arm's Length Price

[Modified - Page 46: lines 11-12 and 18-23; page 47: Table 13; and page 49: Table 14]

As indicated in Section 2.4.2.2, Hydro charges Nalcor and each of its other lines of business their share of telephone infrastructure including long distance charges.

Based on information shown in Table 13 and Table 14, Hydro determined its cost to be recovered for providing access to its telephone infrastructure to be roughly $0.42 million during 2013. There was no evidence provided to indicate the types of expenses included in the costs to be recovered.

The LAN costs provided by the Network Services department are divided by the total number of LAN ports to derive a cost per user. The telephone costs provided by the Network Services department are divided by the number of telephone, fax, and modem lines to derive a cost per telephone per user. The average number of users for each line of business is the allocator.

As shown in Table 13 and Table 14, Hydro charged its affiliates roughly $0.13 million for telephone infrastructure-related costs during 2013. By charging back these costs to its affiliates, Hydro recovered roughly 29.6 percent of its telephone infrastructure-related costs during 2013. Hydro expects its telephone infrastructure-related costs to grow by 2.2 percent during the 2014 test year and 2.5 percent during the 2015 test year. Hydro expects to recover 33.8 percent of its future telephone infrastructure-related costs by allocating these common expenses to its affiliates during the 2014 test year and 34.3 percent during the 2015 test year.[54]

[54] Hydro stated in PUB-NLH-416 that identifying which of Nalcor's other lines of business were the recipients of Hydro's telephone infrastructure-related costs are not warranted for an understanding and assessment of the issues before the Board.

Table 13
Newfoundland and Labrador Hydro
Network Services (LANS) Allocations to Nalcor Energy's Other Lines of Business
December 31, 2011-2015
CAN 000s

		2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
A	Costs allocated	195.3	195.3	186.0	190.1	194.8
	Allocations (Square Footage)					
B	Hydro Regulated	0.8	0.7	1.0	1.0	0.7
C	Other lines of business	0.2	0.2	0.3	0.3	0.5
b	**Total**	**1.0**	**1.0**	**1.2**	**1.2**	**1.2**
E	Cost per square foot (A/D)	198.4	198.4	149.9	153.2	157.0
	Allocations					
F	Hydro Regulated (B*E)	157.9	146.2	148.3	146.1	112.8
G	Other lines of business (C*E)	37.3	49.0	37.7	44.0	82.0
	Total	**195.3**	**195.3**	**186.0**	**190.1**	**194.8**

Source: Hydro's 2013 Amended GRA, PUB-NLH-207-R-1.
Note: Numbers might not add due to rounding.

Table 14
Newfoundland and Labrador Hydro
Network Services (Telephones) Allocations to Nalcor Energy's Other Lines of Business
December 31, 2011-2015
CAN 000s

		2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Test Year)	2015 (Test Year)
A	Costs allocated	223.8	223.8	236.1	241.3	247.4
	Allocations (Square Footage)					
B	Hydro Regulated	0.6	0.5	0.4	0.4	0.5
C	Other lines of business	0.2	0.2	0.3	0.3	0.2
b	**Total**	**0.8**	**0.8**	**0.7**	**0.7**	**0.7**
E	Cost per square foot (A/D)	298.4	298.4	347.3	354.9	363.8
	Allocations					
F	Hydro Regulated (B*E)	167.6	150.1	148.7	139.4	177.7
G	Other lines of business (C*E)	56.2	73.7	87.4	101.9	69.7
	Total	**223.8**	**223.8**	**236.1**	**241.3**	**247.4**

Source: Hydro's 2013 Amended GRA, PUB-NLH-208-R1.
Note: Numbers might not add due to rounding.

Based on this evidence, I have concluded the following:

- Further inquiry is warranted to confirm that the telephone infrastructure costs to be recovered by Hydro from Nalcor and its other lines of business are fully burdened and do not include any non-operating expenses;
- Allocating the telephone infrastructure-related costs to be recovered using the average number of users as the allocator is reasonable; and
- Treating the telephone infrastructure-related costs to be recovered as flow through costs and charging them back without a mark-up is reasonable.

4.3.3 Other Expenses

4.3.3.1 Determining Whether a Service had been Rendered

[Modified - Lines 7-8]

Evidence that Hydro incurs other expenses not covered by the Administration Fee that also benefit, in part, Nalcor's other lines of business was presented in Section 2.4.2.3. Based on this evidence, I have concluded the following:

- Hydro initially pays for the cost of certain other expenditures that benefit one or all of Nalcor's lines of business;
- The affiliates derive value from these other expenditures initially paid for by Hydro and would have been willing to pay for these expenditures on its own behalf; and
- These are expenditures for which Hydro should charge the affiliates an arm's length price.

4.3.3.2 Determining an Arm's Length Price

[Modified - Page 49: line 11; page 50: line 1 and Table 15; page 51: lines 3, 6-7, 9, 13 and Table 16; and page 52: lines 1, 3-4, Table 17, and Table 18]

As indicated in Section 2.4.2.3, Hydro charges out some of the other expenses it incurs on behalf of its affiliates either directly or through an allocation.

According to the evidence provided in Hydro's 2013 Amended GRA, the following expenses are clearly related to one of Nalcor's other lines of business and, as a result, Hydro charges the amount back to that line of business directly:

- Audit expenses;
- Cell phone expenses;
- Directors' expenses;
- Directors' fees;
- Freight and courier expenses;
- Group insurance - premiums; and
- Treasury related fees.[55]

In its response to a request for information made by the Board, Hydro provided a table summarizing the amount of these other expenses incurred and expected to be incurred by Hydro from 2007 to 2015.[56] The amounts for 2011-2015 are reproduced in Table 15. These amounts do not reflect the amounts initially paid by Hydro and subsequently charged back to one of Nalcor's other lines of business. The amounts in the table submitted into evidence represent only the amount of these other expenses that Hydro Regulated actually incurred. To clarify the record, Hydro should be asked to confirm that these other expenses are initially paid for by Hydro on behalf of Nalcor's other lines of business and then subsequently charged back to the appropriate line of business. Should Hydro confirm in the positive, a request should be made by the Board to have Hydro provide a table indicating the dollar amount of these other expenses initially paid for by Hydro, the dollar amount it subsequently charged back to one of Nalcor's other lines of business, and the dollar amount that Hydro Regulated ultimately bore. Apart from the group insurance premiums, the magnitude of these other expenses are not material.

[55] See Hydro's 2013 Amended GRA, Section 3.4.3.3, pages 3.16-3.18.
[56] See Hydro's 2013 Amended GRA, PUB-NLH-155.

Table 15 Newfoundland and Labrador Hydro Select Other Expenses Incurred December 31, 2011-2015 CAN 000s	2011 *(Actual)*	2012 *(Actual)*	2013 *(Actual)*	2014 *(Test Year)*	2015 *(Test Year)*
Audit	84.0	135.0	181.0	113.0	109.0
Cell Phone	210.0	211.0	215.0	224.0	201.0
Directors Expenses	(16.0)	10.0	12.0	72.0	30.0
Directors' Fees	13.0	31.0	26.0	45.0	55.0
Freight and Courier	471.0	383.0	536.0	440.0	460.0
Group Insurance - Premiums	2,546.0	2,403.0	2,372.0	2,469.0	2,567.0
Insurance	1,965.0	2,109.0	2,422.0	2,689.0	2,607.0
Treasury Related Fees	96.0	105.0	108.0	96.0	105.0
Total	**5,369.0**	**5,387.0**	**5,872.0**	**6,148.0**	**6,134.0**

Source: Hydro's 2013 Amended GRA, PUB-NLH-155-R2.
Note: Numbers might not add due to rounding.

According to the evidence provided in Hydro's 2013 Amended GRA, insurance expenses are either direct billed or allocated as per industry standard.[57] In its response to a request for information made by the Board, Hydro provided a table summarizing the amount of these insurance expenses incurred and expected to be incurred by Hydro from 2007 to 2015.[58] The amounts for 2011-2015 are reproduced in Table 16. In its response to a separate request for information made by the Board, Hydro stated that insurance premiums related to Hydro's regulated and non-regulated activities are billed directly to Hydro and allocated using allocations provided by the insurance broker.[59] There was no evidence to verify that Hydro initially paid for insurance premiums on behalf of Nalcor's other lines of business and then subsequently charged them back to one of Nalcor's other lines of business. To clarify the record, Hydro should be asked to confirm that insurance premiums are initially paid for by Hydro on behalf of Nalcor's other lines of business and then subsequently charged back to the appropriate line of business. Should Hydro confirm in the positive, a request should be made by the Board to have Hydro provide a table indicating the total amount of these insurance premiums initially paid for by Hydro, the amount of these insurance premiums that it subsequently charged back to one of Nalcor's other lines of business, and the amount of these insurance premiums that Hydro Regulated ultimately bore.

[57] See Hydro's 2013 Amended GRA, Section 3.4.3.3, page 3.17.
[58] See Hydro's 2013 Amended GRA, PUB-NLH-155.
[59] See Hydro's 2013 Amended GRA, PUB-NLH-160 (Revision 1).

Table 16 Newfoundland and Labrador Hydro Insurance Expenses December 31, 2011-2015 CAN 000s					
	2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
Hydro regulated	1,965.0	2,109.0	2,422.0	2,689.0	2,607.0
Hydro non-regulated	24.0	57.0	136.0	147.0	222.0
Total	**1,989.0**	**2,166.0**	**2,558.0**	**2,836.0**	**2,829.0**

Source: Hydro's 2013 Amended GRA, PUB-NLH-155-R2, 160-R2.

Note: See Hydro's 2013 Amended GRA, PUB-NLH-042 for details regarding the July 1, 2013 premium renewal. There is no indication in the evidence that the amount expected to be paid by Hydro's non-regulated activities changed based on the premium renewal.[60]

The costs of corporate memberships encompass costs related to industry and professional organizations. With the exception of memberships with the Canadian Electric Association ("CEA"), according to the evidence provided in Hydro's 2013 Amended GRA, the majority of corporate memberships are initially paid for by Hydro and subsequently charged back to Nalcor and its other lines of business directly. CEA memberships are allocated by Hydro based on megawatts of generation, energy sales and kilometres of transmission line. Hydro expects to incur $100,000 in 2014 and 2015 for its share of CEA memberships. There is no indication in the evidence regarding the total amount that Hydro will spend on corporate memberships, including CEA memberships, and subsequently charge back to one of Nalcor's other lines of business. The amount of these corporate memberships is not expected to be material.[61]

According to the evidence provided in Hydro's response to a request for information, advertising is administered by Nalcor for all of its lines of business.[62] Further evidence provided in Hydro's response indicates that Nalcor allocates these advertising expenses to Hydro on a case-by-case basis. However, evidence provided in Hydro's 2013 Amended GRA indicates that it is Hydro that initially pays for these advertising expenses and allocates them back to Nalcor's other lines of business.[63] In its response to a request for information made by the Board, Hydro provided a table summarizing the amount of these advertising expenses incurred and expected to be incurred by Hydro from 2007 to 2015.[64] The amounts for 2011-2015 are reproduced in Table 17. There was no evidence to verify that Hydro initially paid for advertising expenses on behalf of Nalcor's other lines of business and then subsequently charged back to one of Nalcor's other lines of business. To clarify the record, Hydro should be asked to confirm that advertising expenses are initially paid for by Hydro on behalf of Nalcor's other lines of business and then subsequently charged back to the appropriate line of business. Should Hydro confirm in the positive, a request should be made by the Board to have Hydro provide a table indicating the total amount of these advertising expenses initially paid for by Hydro, the amount of these advertising expenses that it subsequently charged back to one of Nalcor's other lines of business, and the amount of these advertising expenses that Hydro Regulated ultimately bore.

[60] Hydro stated in PUB-NLH-411 and PUB-NLH-412 that identifying which of Nalcor's other lines of business were the recipients of Hydro's IS-related services was not warranted for an understanding and assessment of the issues before the Board.

[61] Hydro stated in PUB-NLH-411 and PUB-NLH-412 that identifying which of Nalcor's other lines of business were the recipients of Hydro's IS-related services was not warranted for an understanding and assessment of the issues before the Board.

[62] See Hydro's 2013 Amended GRA, PUB-NLH-157.

[63] See Hydro's 2013 Amended GRA, Section 3.4.3.3, pages 3.16 and 3.17.

[64] See Hydro's 2013 Amended GRA, PUB-NLH-156 (Revision 1).

Table 17 Newfoundland and Labrador Hydro Advertising Expenses December 31, 2011-2015 CAN 000s					
	2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
Electricity Education Campaign	153.5	17.6	82.6	20.0	20.5
PowerLine Safety Campaign	47.7	24.8	56.3	160.0	164.0
Media Campaigns / Other	7.0	5.7	2.1	N/R	N/R
Public Safety Advertising	N/R	120.1	186.8	190.0	194.8
Total	**208.2**	**168.2**	**327.8**	**370.0**	**379.3**

Source: Hydro's 2013 Amended GRA, PUB-NLH-156-R2.
Note: Numbers might not add due to rounding.

According to the evidence provided in Hydro's 2013 Amended GRA and its response to a request for information made by the Board, annual general meeting and annual report expenses are shared between Nalcor's lines of business and allocated on a case-by-case basis.[65] As shown in Table 18, Hydro incurred $18,400 during 2013 and expects to incur $18,400 and $18,860 during the 2014 and 2015 test years, respectively. Unless the annual general meeting and annual report expenses were incurred by Hydro for its own governance purposes, they should have been charged back to Nalcor and not allocated to its lines of business as they are stewardship expenses and should be borne by the parent company.

Table 18 Newfoundland and Labrador Hydro Annual General Meeting and Annual Report Expenses December 31, 2011-2015 CAN 000s					
	2011 *(Actual)*	**2012** *(Actual)*	**2013** *(Actual)*	**2014** *(Test Year)*	**2015** *(Test Year)*
Annual General Meeting	2.1	3.0	3.4	3.4	3.5
Annual Report	10.6	8.6	15.0	15.0	15.4
Total	12.7	11.6	18.4	18.4	18.9

Source: Hydro's 2013 Amended GRA, PUB-NLH-164-R1.
Note: Numbers might not add due to rounding.

[65] See Hydro's 2013 Amended GRA, Section 3.4.3.3, page 3.17 and PUB-NLH-165.

Based on this evidence, I have concluded the following:

- Further clarification is warranted regarding which of the other expenses are initially paid for by Hydro and subsequently charged back to one of Nalcor's other lines of business. Hydro should be asked to provide the dollar amount of the other expenses that were charged back to Nalcor's other lines of business;
- With the exception of some potential shareholder costs, Hydro initially pays for the cost of certain other expenditures which should be charged back to a specific affiliate or allocated amongst its affiliates at cost; and
- Treating these other expenses as flow through costs and charging them back without a mark-up is reasonable.

4.4 Corporate Services Rendered to and by Newfoundland and Labrador Hydro

4.4.1 Determining Whether a Service had been Rendered

[Unchanged]

Evidence that Nalcor or its other lines of business rendered corporate services to Hydro and that Hydro rendered corporate services to Nalcor or its other lines of business was presented in Section 2.5 of this report. Based on this evidence, I have concluded the following:

- These corporate services would ordinarily be considered intra-group services;
- Hydro derives value from the corporate services rendered by Nalcor or its other business lines and would have been willing to pay for these corporate-related services had they been provided by an independent enterprise, or would have performed the activity on its own behalf in-house;
- The affiliates derive value from the corporate-related services rendered by Hydro and would have been willing to pay for these corporate services had they been provided by an independent enterprise, or would have performed the activity on their own behalf in-house; and
- Hydro and Nalcor rendered corporate-related services for which an arm's length price should be charged.

4.4.2 Determining an Arm's Length Price

[Modified - Page 54: line 13; and page 56: Table 19]

Nalcor and its affiliates determine the amount charged to each affiliate for which corporate-related services are rendered based on the direct charge method, without including a profit margin.

The amount charged by Nalcor or any of its lines of business, including Hydro, for corporate-related services rendered is based on the amount of time spent by an employee performing the service and the employee's labour rate.

Nalcor employees that perform corporate-related services, including those at Hydro, are required to complete weekly time sheets which allocate their time to specific work orders. Time is coded in 30 minute increments.

An employee's labour rate is determined on a cost recovery basis designed to recover salary, benefits, and indirect overhead. It does not include a profit margin. The labour rate includes a billing rate and a fixed charge.

The billing rate is determined based on an employee's hourly wage amount plus a variable component equal to 57 percent of the hourly wage amount to recover fringe costs (*e.g.*, CPP, Public Service Pension Plan), insurance, company costs (*e.g.*, payroll taxes, bonus), and leave (*e.g.*, statutory holidays, jury duty, standby allowance, and sick leave).[66]

The bill rates are reviewed annually and updated accordingly.

The fixed charges are intended to recover overhead costs (non-salary and benefit costs) directly associated with employees. The following costs are included in the fixed overhead charge calculation:

- Common services rendered by Hydro to Nalcor's lines of business;
- Office space costs allocated by Hydro to Nalcor's lines of business; and
- Other employee related expenses such as telephone and fax, books and subscriptions, membership and dues, conferences, training and other employee expenses.

The fixed charge rate is reviewed annually and updated accordingly by Nalcor for all of its lines of business. As shown in Table 19, the rate for 2012 was $13.10 per hour to a maximum of $98.25 per day. This rate has not been modified for 2013 or subsequent years. Although most employees who render shared services are located in Hydro Place, this rate is also used as a proxy for employees working from other locations.

In the case of overtime, the labour rate is not applied and overtime is billed as incurred in accordance with the standard overtime policy.

[66] See Appendix E for a detailed listing of the components for the bill rate.

Table 19
Newfoundland and Labrador Hydro
Select Other Expenses Incurred
December 31, 2011-2015
CAN 000s

	2011 (Actual)	2012 (Actual)	2013 (Actual)	2014 (Test Year)	2015 (Test Year)
Other Employee Related Costs	2.33	1.36	1.36	1.36	1.36
Hydro Place IS Share	2.40	3.50	3.50	3.50	3.50
Hydro Place HROE Share	1.67	1.14	1.14	1.14	1.14
Subtotal	6.40	6.00	6.00	6.00	6.00
Hydro Place Operating & Capital Expenses	4.27	6.38	6.38	6.38	6.38
Computer Costs	0.0	0.42	0.42	0.42	0.42
Telephone Costs	0.0	0.21	0.21	0.21	0.21
LAN Costs	0.0	0.09	0.09	0.09	0.09
Total Fixed Charge Hourly Rate	10.67	13.10	13.10	13.10	13.10
Hours Per Day	7.50	7.50	7.50	7.50	7.50
Daily Fixed Charge Rate	**80.03**	**98.25**	**98.25**	**98.25**	**98.25**

Source: Hydro's 2013 Amended GRA, PUB-NLH-268 and 269-R1.
Note: In 2012, the methodology was revised to be consistent with the Administration-Fee.
Note: Numbers might not add due to rounding.

Although it is likely that Nalcor and its affiliates incur professional corporate-related services, there is no indication in the evidence that they engaged third parties to render any of the same corporate-related services rendered amongst the affiliates. It is also likely that any such market data would include an unidentifiable profit element. Accordingly, there is no evidence that there are internal comparable uncontrolled transactions upon which to determine an arm's length price using a comparable price method.

Based on this evidence, I have concluded the following:

- Charging corporate-related services rendered by Nalcor or any of its lines of business to an affiliate using a direct charge method is reasonable;
- Basing the labour rate on an employee's base wage plus a variable component to recover benefits and other employee costs and a fixed component to recover indirect overhead is reasonable;
- The proxy used to calculate the portion of the labour rate intended to cover fringe benefits, including leaves, should be re-evaluated on an annual basis; and
- Not applying a mark-up to the costs of rendering corporate services is reasonable.

5 Materiality of the Affiliate Transactions

[Modified - Page 56: heading, 1-5 and Table 20]

As shown in Table 20, Hydro expects a net decrease of $6.5 million in its operating costs during the 2015 test year as a result of affiliate transactions related to common services, common expenses, corporate services and other expenses. The net decrease of $6.5 million is the result of $9.6 million of charges from Hydro to its affiliates for common and corporate service rendered or common expenses initially borne by Hydro and charged back to its affiliates. The remaining $3.1 million involved charges to Hydro from its affiliates for corporate services rendered. If the amount charged by Hydro to its affiliates was understated or the amount charged to Hydro by its affiliates overstated, Regulated Hydro's revenue requirement would be overstated as would the rate increase sought by Hydro.

Table 20
Newfoundland and Labrador Hydro
Projected Affiliate Transactions
2015 Test Year
CAN 000s

Common services charged to affiliates	4,202.2
Common expenses charged to affiliates	1,451.4
Other expenses charged to affiliates	0.0
Corporate services charged to affiliates	3,952.1
Subtotal	**9,605.7**
Less: Corporate services charged by affiliates	3,118.0
Total	**6,487.7**

Source: Own calculations based on information from Tables 1, 2, and 3.
Note: Numbers might not add due to rounding.

5.1 Sensitivity Analysis

[Modified - Page 56: lines 11-12; and page 57: lines 1, 6-7, Table 21, and Table 22]

To demonstrate that the rate increase sought by Hydro is not very sensitive to the potential refinements to Nalcor's intercompany pricing policy identified in Section 4, I undertook the following sensitivity analysis. In Table 21, I present my estimate of the effective rate per kWh required by Hydro to achieve its estimated revenue requirement for NPI during the 2015 test year to be 8.9 cents.

Table 21 Newfoundland and Labrador Hydro Projected Effective Rate per kWh 2015 Test Year CAD	
Revenue requirement	525,318,632
Estimated usage (kWh)	5,924,100,000
Effective rate (kWh)	0.089

Source: Hydro's 2013 Amended GRA, Exhibit 13, Schedules 1.3.1 and 1.3.2.

Based on a rate model that is consistent with Hydro targeting the same return on equity as NPI, any change in the amounts charged by or to Hydro for the Administration Fee or corporate services would alter Hydro's revenue requirement and, in turn, the effective rate per kWh. For example, an increase of $1 million in the amount charged for common services rendered by Hydro to its affiliates would reduce Hydro's revenue requirements by a corresponding amount. As shown in Table 22, that $1 million reduction in the amount charged by Hydro to its affiliates would not have a material impact on the effective rate per kWh. A reduction of $2 million would be required before changing the effective rate per kWh for NPI by one-tenth of a cent. Accordingly, the potential understatements of the amounts charged by Hydro for rendering common services to its affiliates as described in Section 4.2.1.2 of this report would not be material.

Table 22
Newfoundland and Labrador Hydro
Sensitivity Analysis
2015 Test Year
CAD

Increase/Decrease in charges for affiliate transactions	Change in required revenue	Revised Revenue	Estimated Usage (kWh)	New Effective Rate	Change in Effective Rate
3,000,0000	3,000,000	528,318,632	5,924,100,000	0.089	0.000
2,000,000	2,000,000	527,318,632	5,924,100,000	0.089	0.000
1,000,000	1,000,000	526,318,632	5,924,100,000	0.089	0.000
Base Case		**525,318,632**	**5,924,100,000**	**0.089**	
(1,000,000)	(1,000,000)	524,318,632	5,924,100,000	0.089	0.000
(2,000,000)	(2,000,000)	523,318,632	5,924,100,000	0.088	(0.001)
(3,000,0000)	(3,000,0000)	522,318,632	5,924,100,000	0.088	(0.001)

Source: Own calculations based on Hydro's 2013 Amended GRA, Exhibit 13, Schedules 1.3.1 and 1.3.2.

6 Conclusion

[Modified - Page 58: lines 1, 11, 20-25 and 31; and page 59: lines 1-2, 15-16, 29-31 and 34-36]

With respect to the common services that Hydro renders for its affiliates, based on the information relied upon, it is my opinion that:

- Hydro renders common services (i.e., services related to HR, safety and health, and IS) to its affiliates that would ordinarily be considered intra-group services;
- The affiliates derive value from the common services rendered by Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activities on their own behalf in-house;
- Hydro renders common services to its affiliates for which an arm's length price should be charged;
- Using an indirect charge method to determine an arm's length price for the common services Hydro renders to its affiliates is reasonable;
- The common services-related costs to be recovered through the Administration Fee might not be fully burdened and, as a result, the amount to be charged by Hydro to its affiliates for these common services might be understated. The magnitude of the potential increase in the amounts to be charged by Hydro to its affiliates for rendering these common services would not be material;
- Allocating the HR, and safety and health-related costs to be recovered using FTEs as the allocator is reasonable;
- Allocating the IS-related costs to be recovered using average number of users as the allocator is reasonable;
- Unless the ultimate recipient of the common service rendered is an energy project involving private interests, not marking-up the common service-related costs to be recovered is reasonable. Otherwise, the costs should be marked-up by at least two percent to five percent; and
- Further clarification is warranted regarding the amount charge to and which of Nalcor's other lines of business and which external parties Hydro recovered common services-related costs.

With respect to the common expenses that Hydro initially pays on behalf of itself and its affiliate, based on the information relied upon, it is my opinion that:

- Hydro initially pays for the cost of common expenditures that benefit all of Nalcor's lines of business;
- The affiliates derive value from the common expenditures initially paid for by Hydro and would have been willing to pay for these expenditures on their own behalf;
- Hydro initially pays for the cost of common expenditures which should be charged back to its affiliates;
- The common costs to be recovered are fully burdened and do not include any non-operating expenses;
- Allocating the building rental costs to be recovered using square footage occupied as the allocator is reasonable;
- Allocating the telephone infrastructure-related costs to be recovered using the average number of users as the allocator is reasonable; and
- Treating these common expenses as flow through costs and charging them back without a mark-up is reasonable.

With respect to the other expenses that Hydro initially pays on behalf of itself and its affiliates, based on the information relied upon, it is my opinion that:

- Hydro initially pays for the cost of certain other expenditures that benefit one or all of Nalcor's lines of business;
- The affiliates derive value from these other expenditures initially paid for by Hydro and would have been willing to pay for these expenditures on its own behalf;
- Further clarification is warranted regarding which of the other expenses are initially paid for by Hydro and subsequently charged back to one of Nalcor's other lines of business. Hydro should be asked to provide the dollar amount of the other expenses that were charged back to Nalcor's other lines of business;
- With the exception of some potential shareholder costs, Hydro initially pays for the cost of certain other expenditures which should be charged back to a specific affiliate or allocated amongst its affiliates at cost; and
- Treating these other expenses as flow through costs and charging them back without a mark-up is reasonable.

With respect to the corporate services that Hydro renders for its affiliates and its affiliates render for Hydro, based on the information relied upon, it is my opinion that:

- Hydro and its affiliates render corporate services that would ordinarily be considered intra-group services;
- Hydro and its affiliates derive value from the corporate services rendered by its affiliates or Hydro and would have been willing to pay for these services had they been rendered by an independent enterprise, or would have performed the activity on its own behalf in-house;
- Hydro and its affiliates render corporate services to each other for which an arm's length price should be charged;
- It is reasonable for Hydro and its affiliates to use an direct charge method to determine an arm's length price for the corporate services it renders to its affiliates;
- The labour rates used to recover the costs of rendering these corporate services appear to be fully-burdened and do not include any non-operating expenses;
- The proxy used to calculate the portion of the labour rate intended to cover fringe benefits, including leaves of absence, should be re-evaluated on an annual basis; and
- Unless the ultimate recipient of the corporate service rendered is an energy project involving private interests, not applying a mark-up to the costs of rendering corporate services to be recovered is reasonable. Otherwise, the costs should be marked-up by at least two percent to five percent.

My opinion is based on:

- My expertise and experience in transfer pricing;
- The evidence submitted by Hydro in its 2013 Amended GRA;
- The evidence submitted by Hydro in its initial and revised responses to the requests for information;
- Publicly available documents cited in this report; and
- The evaluation framework I developed in Section 3 of this report.

Appendix A: Brad Rolph's Curriculum Vitae

Brad Rolph

Partner - National Transfer Pricing Leader

A.1 Experience

For the past 20 years, Mr. Rolph has helped multinational companies address their transfer pricing issues. Euromoney has recognized Brad as one of Canada's leading transfer pricing advisers in its 2013 Guide to the World's Leading Transfer Pricing Advisers. He was the first economist hired by any accounting firm in Canada to practice transfer pricing exclusively.

His areas of expertise include planning, implementing and documenting intercompany transactions for tangible goods, services and intangibles in a tax-efficient, defendable manner ("TESCM"); building models to price complex financial transactions; resolving audit disputes at the field, appeals and Competent Authority level; negotiating advance pricing arrangements ("APA"); and providing litigation support.

Brad has served companies based in Canada, the United States, England, Ireland, Finland, France, Germany, Sweden, Saudi Arabia and Japan. He has dealt with issues in the following industries: Aerospace, Mining, Metals and Minerals, Pulp and Paper, Transportation, Heavy Manufacturing, Steel, Utilities, Automotive, Chemical, Pharmaceutical, Food and Beverage, Electronic, Financial Services, Wholesale Trade, Apparel, Software, Consumer Goods and Entertainment. He also has extensive experience with Japanese trading companies and web-based businesses.

Previously, Mr. Rolph was a Partner and the Chief Economist of the Canadian transfer pricing practice of a Big Four firm. He also held senior leadership positions with two transfer pricing boutiques.

Brad is a frequent speaker and commentator on transfer pricing matters. He has been published in International Tax Review, Euromoney and Tax Management International. Brad has also been a tutorial leader at the CPA's In-Depth Transfer Pricing course.

In addition to an Honours Bachelor of Arts degree in economics from Wilfrid Laurier University and a Masters of Arts degree in economics from Queen's University, Brad has completed the course work and comprehensive theory exams in economics at the Ph.D. level at York University.

A.2 Recent Transfer Pricing Engagements

A.2.1 TESCM

- Restructured the supply chain of a Canadian based manufacturer to address expansion in the U.S.
- Restructured the supply chain of a Canadian-based manufacturer to address U.S. customs issues.
- Planned the transfer pricing policies for a Canadian-based start-up internet media publishing company with U.S. operations.
- Planned the transfer pricing policies for buy-sell tangible goods transactions between a Canadian pharmaceutical company and its limited function/risk U.S. subsidiary so as to maximize profits in Canada.
- Planned and documented transfer prices for chemicals sold by a manufacturing parent in Saudi Arabia to European customers through subsidiaries in Switzerland and the Netherlands fees so as to maximize profits reported in Saudi Arabia.

A.2.2 Financial Transactions

- Supported the quantum and related interest rates for intercompany loans between a Canadian-based professional services firm and its U.S. subsidiary.
- Determined fees for parent guarantees provided by a Canadian manufacturing company to subsidiaries in the Aerospace and Transportation industries.
- Estimated the credit rating for a Canadian subsidiary of a Swedish heavy manufacturing company.
- Developed a Monte Carlo simulation model to determine the base rate of interest for profit participating debt instruments between:
    - Belgium and Latvia affiliates of a Finnish utility company;
    - Belgium and Lithuania affiliates of a Finnish utility company; and
    - Canadian and Luxembourg affiliates of a U.S. water treatment business.
- Developed a Monte Carlo simulation model to convert a fixed rate of interest to a floating rate for intercompany loans involving countries for which Bloomberg's Swap Manager does not have such capabilities.
- Estimated loan guarantee fees between related parties of a Finnish utility company.
- Estimated credit ratings and developed a methodology to determine interest rates on short-term and long term loans for 33 subsidiaries in Finland, Sweden, Norway, the Baltics, Russia, France and England for a Finnish utility company. This project required estimating credit ratings for unregulated utilities, unregulated power companies, regulated utilities, service companies and five captive finance entities.
- Estimated credit ratings for almost 20 U.S. and foreign subsidiaries and provided preliminary estimates of associated interest rates on long term debt for a French heavy manufacturing company.
- Estimated the credit rating and used regression analysis to determine the discount rate on preferred shares issued by a Singapore affiliate of a French mining company.
- Estimated the credit rating and the discount rate on preferred shares issued by a U.S. affiliate of a Canadian steel company.
- Determined an interest rate for funds advanced periodically to fund pre-export activities on sales of coal by a Columbian subsidiary of a U.S. mining company.
- Estimated the credit ratings, the interest rate on intercompany loans and the discount rates on preferred shares between subsidiaries in Finland, Spain and Turkey for a Canadian mining company.

A.2.3 Audit Dispute Resolution

- Negotiated a settlement of transfer pricing adjustments at the Appeals Branch of the CRA for the Canadian subsidiary of a U.S. provider of information technology services. The transactions involved the provision of information technology services by the Canadian subsidiary to its U.S. parent.
- Developed a model to defend the transfer pricing policies of a Canadian food processor against a CRA reassessment at Competent Authority. The transaction at issue was a buy-sell tangible goods transaction involving a limited function/risk distributor.
- Obtained a downward adjustment for the Canadian subsidiary of a U.S. business service provider during a transfer pricing audit.
- In anticipation of an audit, measured the exposure related to transfer pricing policies for transactions involving the sale and purchase of tangible goods used as inputs between a Canadian pulp manufacturer and affiliated paper manufacturers in Canada and the U.S.

A.2.4 Advanced Pricing Arrangements

- Requested a unilateral APA with the CRA for a Canadian subsidiary of a US pharmaceutical company.
- Requested a bilateral APA between the CRA and the Internal Revenue Service for a U.S. alcoholic beverage company.
- Negotiated a unilateral APA for a Canadian subsidiary of U.S. automotive parts supplier.

A.2.5 Expert Witness/Litigation Support

- Supporting counsel to object against transfer pricing adjustments assessed against a Canadian real estate developer. This matter is currently before the Tax Court of Canada.
- Supporting counsel to appeal transfer pricing adjustments assessed against a Canadian food harvester on its sales of food product to an off-shore affiliate. This matter is currently before the Tax Court of Canada.
- Prepared expert witness reports at the request of counsel on a matter involving intercompany services rendered and arranged by a Canadian service provider to an off-shore, web-based affiliate. The first report was issued in support of a notice of appeal issued to the Appeals Branch of the CRA. The second report was issued in support of the audit defense for subsequent taxation years.
- Prepared draft expert witness reports at the request of counsel on a matter involving the appropriate discount rates for the factoring of accounts receivable. The matter is currently before the Federal Court of Appeals.
- Supported the work of an expert witness on a matter involving the tax treatment of lawsuit settlement expenses. The matter is currently before the Tax Court of Canada.
- Supported the work of an expert witness on a matter involving the appropriate rate for guaranteeing bank deposits that was before the Tax Court of Canada. The matter was settled.
- Supported the work of an expert witness on a matter involving the transfer pricing policies of a North American automotive manufacturer that was before the Ontario Superior Court.

A.3 Recent Presentations

Risk Shifting Considerations: Economic Viewpoints, panelist, University of San Diego, 3rd Annual Transfer Pricing Symposium, April 23, 2015, San Diego, California.

Industry Panel on Intra-Group Financing, moderator, TP Minds Transfer Pricing Summit Americas 2015, February 25, 2015, Miami, Florida.

Customs Valuation and Transfer Pricing: Comparing Canada and U.S. Interpretations, presenter with Joy Nott, Canadian Importers and Exporters Association Webinar Series, September 25, 2014.

Customs Valuation and Transfer Pricing: Review of the Methodologies, presenter with Joy Nott, Canadian Importers and Exporters Association Webinar Series, September 11, 2014.

Customs Valuation and Transfer Pricing: Starting from the Beginning, presenter with Joy Nott, Canadian Importers and Exporters Association Webinar Series, August 20, 2013.

Transfer Pricing Update - Transfer Pricing in Other Countries, Networking Seminars, April 29, 2014, New York, New York.

Related Party Pricing & Transfer Pricing in the Oil and Gas Industries, presenter with Joy Nott and Lisa Zajko, Canadian Importers and Exporters Association, Western Regional Conference, February 27, 2014, Calgary, Alberta.

Best Practices in Transfer Pricing Planning and Implementation, presenter with Joy Nott and Glen Haslhofer, Insight, Latest Transfer Pricing Updates and Best Practices in Planning, Implementation and Documentation, February 21, 2014, Toronto, Ontario.

Customs Valuation and Transfer Pricing Boot Camp, presenter with Joy Nott and Lisa Zajko, Canadian Importers and Exporters Association, July 9-10, 2013.

Customs Valuation and Transfer Pricing: Comparing Canada and U.S. Interpretations, presenter with Joy Nott, Canadian Importers and Exporters Association Webinar Series, May 2, 2013.

Customs Valuation and Transfer Pricing: Review of the Methodologies, presenter with Joy Nott, Canadian Importers and Exporters Association Webinar Series, April 18, 2013.

Customs Valuation and Transfer Pricing: Starting from the Beginning, presenter with Joy Nott, Canadian Importers and Exporters Association Webinar Series, April 4, 2013.

The International Traders' Trifecta: International Tax, Transfer Pricing and Integrated Supply Chain, co-presenter with Claire Kennedy, Canadian Importers and Exporters Association, Transfer Pricing & International Tax Conference, October 16, 2012, Mississauga, Ontario.

Dispute Resolution: Global Approaches to Global Issues, panelist, International Tax Review, 12th Annual Global Transfer Pricing Forum, September 26, Paris, France.

A Global Transfer Pricing Update, Trends & Outlook with a U.S. Spin, presenter with Kathrine Kimball, Networking Seminars, U.S. - Canada International Tax Planning Conference, March 26, 2012, New York, New York.

Transfer Pricing, panelist, Boston Bar Association, Update on International Tax Compliance and Reporting, Transfer Pricing & International Tax Reform, March 21, 2012, Boston, Massachusetts.

Developing an Effective Advance Pricing Agreement (APA) in Anticipation of an Audit, panelist, Infonex, 16th Annual Transfer Pricing Conference, March 7, 2012, Toronto, Ontario.

Understanding Guarantee Fees, presenter, Infonex, 16th Annual Transfer Pricing Conference, March 7, 2012, Toronto, Ontario.

Understanding Guarantee Fees, presenter, Infonex, Latest Developments in Global Transfer Pricing Conference, October 18, 2011, Williamsburg, Virginia.

Intercompany Services, presenter with Brian Andreoli, Networking Seminars U.S. - Canada International Tax Planning Conference, September 26, 2011, Toronto, Ontario.

Advanced Pricing Arrangements, presenter, Canadian Importers and Exporters Association, Transfer Pricing & International Tax Conference, May 9, 2011, Toronto, Ontario.

Understanding the Economics of Transfer Pricing, presenter, Infonex, Key Issues in Global Transfer Pricing, April 1, 2011, San Diego, California.

An Introduction to Transfer Pricing, presenter, Infonex, Key Issues in Global Transfer Pricing, Pre-conference Workshop, March 30, 2011, San Diego, California.

The Canadian & U.S. Transfer Pricing Update: Trends & Outlook, presenter with Kathrine Kimball, Infonex, 15th Annual Transfer Pricing Update, February 2, 2011, Toronto, Ontario.

An Introduction to Transfer Pricing, presenter, Infonex, 15th Annual Transfer Pricing Update, Pre-conference Workshop, February 1, 2011, Toronto, Ontario.

Understanding Financial Transactions, presenter with Anne Lam, Infonex, Key Issues in Global Transfer Pricing, September 28, 2010, Chicago, Illinois.

Forum for In-house Transfer Pricing Practitioners, presenter, Infonex, 14th Annual Transfer Pricing Update, Post-conference Workshop, January 28, 2010, Toronto, Ontario.

Understanding the Economics of Transfer Pricing, presenter, Infonex, 14th Annual Transfer Pricing Update, January 27, 2010, Toronto, Ontario.

Review of Current Transfer Pricing Case Law in Canada and the U.S., chair and presenter, CITE, 8th Annual Canada-U.S. Transfer Pricing Symposium, October 21, 2009, Toronto, Ontario.

A.4 Recent Publications

McKesson: A cautionary transfer pricing tale, with Claire Kennedy of Bennett Jones LLP, International Tax Review, February 2014, pp.19-21.

NHL Needs to Stop Rewarding Losers, editorial in the National Post, April 22, 2013.

GlaxoSmithKline case: legal form and economic relevance prevail, with Claire Kennedy of Bennett Jones LLP, International Tax Review, April 2013, pp.47-50.

Canada - U.S. arbitration: Too soon to pass judgement, International Tax Review, September 2012, pp. 38-40.

Canada: A year in review, Euromoney Yearbooks, Transfer Pricing Review 2012/13, pp. 19-22.

To mark-up intra-groups services or not, that is the question, Insights: Transfer Pricing, a Charles River Associates' publication, June 2012.

Canadian budget clarifies treatment of transfer pricing secondary adjustments and forces multinationals to re-evaluate and better monitor cross-border debt, Insights: Transfer Pricing, a Charles River Associates' Publication, March 2012.

In the circumstances: The Supreme Court of Canada hears the GlaxoSmithKline transfer pricing case, Insights: Transfer Pricing, a Charles River Associates' Publication, February 2012.

Canada's obsession with the CUP method leads to strange ruling in Alberta Printed Circuits case, Euromoney Yearbooks, Transfer Pricing Review 2011/12, pp. 33-37.

Canada Intangibles Guide, Transfer Pricing Week—International Tax Review, July 2011.

An alternative approach to measuring adjustments for differences in working capital intensity, Insights: Transfer Pricing, a Charles River Associates' Publication, June 2011.

Federal Court of Appeal upholds decision in GE Capital Canada case, Insights: Transfer Pricing, a Charles River Associates' Publication, February 2011.

Limited-Function Distributors: Alternatives to the Canada Revenue Agency's Co-Distributor Approach, BNA Tax Management Transfer Pricing Report, Vol. 19, No. 2, May 20, 2010, pp. 79-85.

Appendix B: Best Practices Amongst Regulated Canadian Utility Companies

[New]

I performed a survey of utility companies to determine the utility industry's best practices for cost allocations of shared services. In Table 23, I present a list of utility service providers in each province that was compiled using information from Industry Canada and The Electricity Forum's database of utility companies.[67]

I relied on allocation methods used by the utility company with the largest revenues in each province represent the allocation methods used by utility companies in that province. A description of the cost allocation methods used by each of the largest utility companies in each province follows.

[67] Information from Industry Canada was sourced from www.ic.gc.ca/eic/site/mc-mc.nsf/eng/lm00525.html and Information from The Electricity Forum was sourced www.electricityforum.com/links/cdautil.html.

Table 23
Summary of Utility Companies by Province

Company	Province	Revenue (Million)	Notes
ATCO Electric Ltd.	Alberta	4,554	
ENMAX Corporation	Alberta	386	
EPCOR Distribution & Transmission Inc.	Alberta	1,904	
FortisAlberta	Alberta	518	Subsidiary of Fortis Inc.
TransAlta	Alberta	2,623	Based in Alberta and largest operations in Alberta, but operates across North America.
BC Hydro and Power Authority	British Colombia	5,392	
Fortis BC Energy Inc.	British Colombia	334	Subsidiary of Fortis Inc.
Manitoba Hydro	Manitoba	1,914	
New Brunswick Power Corporation	New Brunswick	1,797	
Newfoundland and Labrador Hydro	Newfoundland	796	Not included in the survey, as they are the focus of the expert report.
Nova Scotia Power Inc.	Nova Scotia	1335	Subsidiary of Emera.
Hydro One	Ontario	6,074	
Hydro Ottawa	Ontario	173	
London Hydro Inc.	Ontario	405	
Niagara Peninsula Energy Inc.	Ontario	-	
Oakville Hydro Energy Services Inc.	Ontario	187	Retrieved from 2012 Annual Report.
Maritime Electric	Prince Edward Island	1,008	Subsidiary of Fortis Inc. Revenue reported is for all of Fortis Inc.'s Eastern Canada Operations.
Hyrdo-Québec	Québec	13,638	
SaskPower	Saskatchewan	2,045	
Saskatoon Light & Power	Saskatchewan	-	

B.1 Source: Industry Canada and the annual reports of the respective utility companies.Alberta

Of the utility companies listed in Table 23, ATCO Electric Ltd. ("ATCO") has the largest revenues in Alberta. Publicly available information regarding ATCO's cost allocation methods is available from the Alberta Utilities Commission ("UAC"), the regulatory body which oversees utility companies in Alberta. The UAC published ATCO's 2013-2014 Transmission General Tariff Application issued on September 24, 2013. This publication is the most recent document which details the cost allocation methods used by ATCO. In Table 24, I present the cost allocation methods used by ATCO.

Table 24
ATCO Electric Ltd.
Cost Allocation Methods Used
September 24, 2013

Cost	Allocation Method
General O&M expenditures	• Analysis of Communication costs; • Analysis of Expenditures; • Square Footage analysis; • Average of the Percentages for Revenue; • Net Property Plant & Equipment ("Net PP&E") and Capital Expenditures; • Number of employees training; and • Analysis of Transmission vs Distribution O&M Inventory Transactions.
Common operations	• Number of Employees; • Analysis of Transmission vs Distribution O&M Inventory Transactions; • Average of the Percentages for Revenue; • Net PP&E and Capital Expenditures; • Average number of employee moves; • Analysis of percentage of O&M that relates to each business unit; • Analysis of time spent supervising O&M employees by business unit; • Analysis of expenditures; and • Number of application users.
Corporate A&G expenses	• Insurable Value of PP&E; • Number of Employees; • Number of Vehicles; • Analysis of Expenditures; • Analysis of Capital Expenditures; • Occupied Square Footage; • Revenue Requirement and Analysis of Expenditures; • Average of the Percentages for Revenue; • Net PP&E and Capital Expenditures; and • Internal Review of Services Provided.
Corporate general PP&E	• Assignment of corporate employees to business units; • Proportion of land, buildings & structures directly assigned to each business unit; • Proportion of occupied square footage for corporate areas assigned to each business unit; • Assignment of employees to the business units' • Average of actual revenue; • Year-end Net PP&E and Capital Expenditures.

Source: Page 184 to 186 of the ATCO Electric Ltd. 2013-2014 Transmission General Tariff Application, September 24, 2013 - Schedules 27-1 through to 27-4.

B.2 British Columbia

Of the utility companies listed in Table 23, BC Hydro has the largest revenues in British Columbia. Publicly available information regarding BC Hydro's cost allocation methods is available from the British Columbia Utilities Commission ("BCUC"), the regulatory body which oversees utility companies in British Columbia. The BCUC published BC Hydro's FY2015-16 Revenue Requirements Application issued on March 7, 2014.[68] This publication is the most recent document which details the cost allocation methods used by BC Hydro. In Table 25, I present the cost allocation methods used by BC Hydro.

Table 25
BC Hydro
Cost Allocation Methods Used
March 7, 2014

Cost	Allocation Method
Building Operation Costs	• Floor space occupied
Accenture Business Services for Utilities (ABSU) Support costs	• Expenditures and headcount, or headcount alone
Insurance Cost	• Assets covered by the policies, and risks associated with the operations
Billing System Amortization, and Customer Care	• Allocated to customer care & conservation
Remaining Corporate Costs	• Allocated by the average proportionate shares of expenditures (operating costs and capital) and headcount

Source: Section 7.9, page 7-6 of BC Hydro's F09/F10Revenue Requirements Application.

B.3 Manitoba

Of the utility companies listed in Table 23, Manitoba Hydro has the largest revenues in Manitoba. Publicly available information regarding Manitoba Hydro's cost allocation methods is available from the Manitoba Public Utilities Board ("MPUB"), the regulatory body which oversees utility companies in Manitoba. The MPUB published Manitoba Hydro's 2015/16 & 2016/17 General Rate Application issued on January 16, 2015. This publication is the most recent document which details the cost allocation methods used by Manitoba Hydro. Appendix 5.5, page 15 and page 16, of Manitoba Hydro's 2015/16 & 2016/17 General Rate Application states that capital allocations are based on each division's estimate of the amount of internal labour that is needed to support capital projects and will vary based on the capital projects planned in the year. I subsequently contacted MPUB to request more details on their cost allocation methods and was provided Centra Gas Manitoba Inc.'s, Manitoba Hydro's parent company, cost allocation methods. In Table 26, I present the cost allocation methods used by Centra Gas Manitoba Inc.

[68] Page 5 of BC Hydro's FY2015-16 Revenue Requirements Application states that the allocation methodology used by BC Hydro are based on the DARR allocation table initially approved by the BCUC in its decision on BC Hydro's F09/F10 RRA (DARR Allocation Table) and further confirmed through BCUC Order No. G-77-12A.

Table 26
Centra Gas Manitoba Inc.
Cost Allocation Methods Used
January 16, 2015

Cost	Allocation Method
Activity charges	• Based on time spent
Overhead	• Percentage mark-up on activity charges; Stores overhead, based upon a percentage mark-up on materials used
Vehicle and work equipment costs	• Charged into resource cost centres using unit rates which are calculated based upon the cost of owning and operating this equipment

Source: Page 11 of 2013/14 General Rate Application Cost Allocation Methodology PUB/Centra I-21(a).
Note: Manitoba Hydro is a subsidiary of Centra Gas Manitoba Inc.

B.4 New Brunswick

Of the utility companies listed in Table 23, New Brunswick Power Corporation ("NB Power") has the largest revenues in New Brunswick. Publicly available information regarding NB Power's cost allocation methods is available from the New Brunswick Energy and Utilities Board ("NBEUB"), the regulatory body which oversees utility companies in New Brunswick. The NBEUB published a cost allocation report by KPMG titled NB Power Corporation Review and Update of Overhead Capitalization Rate and Corporate Services Cost Allocation issued on October 23, 2014. This publication is the most recent document which details the cost allocation methods used by NB Power. Page 23 of KPMG's cost allocation report states that the cost allocation methods used by NB Power for its shared services cost are as follows: OM&A expenses, total assets, total revenue, employees, and Net PP&E.

B.5 Newfoundland and Labrador

Newfoundland and Labrador's primary utility company is Hydro. The purpose of my report is to evaluate the reasonableness of the methods used by Hydro and its affiliates to, as such, no survey of Hydro's cost allocation methods was performed.

B.6 Nova Scotia

Of the utility companies listed in Table 23, Nova Scotia Power Inc. ("NS Power") has the largest revenues in Nova Scotia. Publicly available information regarding NS Power's cost allocation methods is available from the Nova Scotia Utility Review Board ("NSUARB"), the regulatory body which oversees utility companies in Nova Scotia. No cost allocation information was provided in NS Power's 2013 General Rate Application filed with the NSUARB. The NSUARB published NS Power Affiliate Code of Conduct 2013 Report issued on May 30, 2014. This publication is the most recent document which details the cost allocation methods used by NS Power. Page 138 of the NS Power Affiliate Code of Conduct 2013 Report states that the cost allocation methods used by NS Power for its corporate support services are as follows: time analysis, project analysis, enterprise employees, total capitalization, number of invoices, number of distribution lines, number of vehicles, asset value, and total revenue.

B.7 Ontario

Of the utility companies listed in Table 23, Hydro One has the largest revenues in Ontario. Publicly available information regarding Hydro One's cost allocation methods is available from the Ontario Energy Board ("OEB"), the regulatory body which oversees utility companies in Ontario. The OEB published Hydro One's Common Corporate Costs, Cost Allocation Methodology issued on December 19, 2013. This publication is the most recent document which details the cost allocation methods used by Hydro One. Page 2 of Hydro One's Hydro One's Common Corporate Costs, Cost Allocation Methodology report states that Hydro One's Planning & Operating and Customer Service groups' costs are allocated based on a time study. Hydro One's Common Corporate Costs, Cost Allocation Methodology report also states that it commissioned a study by Black and Veatch ("B&V") to recommend a best practice methodology to allocate common corporate costs among the business entities using the common services. B&V's Review of Allocation of Common Corporate Costs (Distribution) - 2013 report states the following allocation methods were used: headcount (of employees), number of workstations, invoices to vendors, capital expenditures, net utility plant, program project costs, total capital, and total revenue.

B.8 Prince Edward Island

Of the utility companies listed in Table 23, Maritime Electric has the largest revenues in Prince Edward Island. Publicly available information regarding Maritime Electric's cost allocation methods is available from the Island Regulatory and Appeals Commission ("IRAC"), the regulatory body which oversees utility companies in Prince Edward Island. No cost allocation information was provided in documents published by the IRAC. I subsequently contacted Fortis Inc. ("Fortis"), the parent company of Maritime Electric, to request more information on how costs are allocated among its affiliates. A representative from Fortis stated the following:

"The operating model and approach for the Fortis utilities is that each utility is located in its respective service territory and is responsible for its own standalone operations, including oversight by respective Board of Directors for each utility. In this manner, the "shared services" between Fortis Inc. and its utilities are not as significant as they would be in a centralized environment. There are, however, a number of operating expenses at the Fortis Inc. head office level that do provide benefits to our utility subsidiaries and, as such, certain of these costs are allocated to our utilities and billed to them accordingly. These items include, but are not limited to: board of directors expenses, investor relations expenses, insurance, internal audit, treasury and taxation, financial reporting and audit expenses. All of these types of costs would include associated salaries for these functions. The allocation method used to bill these shared services is based on percentage of Fortis Inc.'s investments (assets) in the various utilities."

B.9 Quebec

Of the utility companies listed in Table 23, Hydro-Québec has the largest revenues in Québec. Hydro holds a 65.8% interest in Churchill Falls (Labrador) Corporation Limited (Churchill Falls), with Hydro-Québec holding the remainder. Hydro-Québec was deemed to be related to Hydro and its affiliates, as such, no survey of Hydro-Québec's cost allocation methods was performed.

B.10 Saskatchewan

Of the utility companies listed in Table 23, SaskPower has the largest revenues in Saskatchewan. Publicly available information regarding SaskPower's cost allocation methods is available from the Saskatchewan Rate Review Panel ("SRRP"), the regulatory body which oversees utility companies in Saskatchewan. No cost allocation information was provided in documents published by the SRRP. I subsequently reviewed SaskPower's 2014, 2015, 2016 Rate Application issued in October 2013. This publication is the most recent document which details the cost allocation methods of SaskPower. Page 28 of SaskPower's 2014, 2015, 2016 Rate Application states that affiliate costa are allocated based on the National Association of Regulatory Utility Commissioner's Guidelines for Cost Allocations. In Table 27, I present the cost allocation methods used by SaskPower.

Table 27
SaskPower
Cost Allocation Methods Used
October 2013

Cost	Allocation Method
Transmission & Distribution	• Cost centre reports
Customer Services	• Cost centre operation, maintenance and administration reports
Corporate & Financial Services	• Employee headcount
Planning, Environment & Regulatory Affairs	• Employee analysis
Safety	• Safety department staff assignments to the Business Units and Support Groups
Corporate Information & Technology	• Employee headcount
Human Resources	• Employee headcount

Source: Page 22 of SaskPower's 2014, 2015, 2016 Rate Application.

B.11 Summary of Search Results for Utility Companies' Cost Allocation Methods

In Table 28, I present the results of my industry survey of intra-group cost allocation methods used by Canadian utility companies. Based on my review of the allocation methods used by the utility company with the largest revenues in each province, it is my opinion that the following allocation methods should be considered depending on the nature of the service rendered:

- Time spent;
- Square footage;
- Number of employees or headcount;
- Costs or expenditures;
- Revenue;
- Assets; and
- Number of transactions, assignments, or projects.

Table 28
Regulated Canadian Utility Companies
Summary of Cost Allocation Methods
2013-2015

Province	Allocation Methods	Notes
Alberta	• Analysis of costs or expenditures; • Square footage; • Revenue; • Number of employees; • Number of transactions; • Time spent; • Number of users; and • Portion of resources assigned to each business unit.	
British Columbia	• Floor space; • Expenditures; • Headcount; and • Assets.	
Manitoba	• Time spent; • Materials used; and • Cost of owning and operating this equipment.	
New Brunswick	• OM&A expenses; • Total assets; • Total revenue • Employees; and • Net PP&E.	
Newfoundland and Labrador	• N/A	The focus of the expert report.
Nova Scotia	• Time analysis; • Project analysis; • Enterprise employees; • Total capitalization; • Number of invoices; • Number of distribution lines; • Number of vehicles; • Asset value; and • Total revenue.	
Ontario	• Time spent; • Headcount (of employees); • Number of workstations; • Invoices to vendors; • Capital expenditures; • Net utility plant; • Program project costs; • Total capital; and • Total revenue.	

Table 28 Regulated Canadian Utility Companies Summary of Cost Allocation Methods 2013-2015		
Prince Edward Island	• Asset value.	
Quebec	• N/A	Related to Newfoundland and Labrador.
Saskatchewan	• Cost specific reports; • Employee head count; and • Assignments.	

Source: Compilation of tables presented in the subsections above.

Appendix C: Tax Administration Guidance

C.1 Determining Whether a Charge for a Service Rendered is Justified

[Modified - Heading, page 77: lines 1; and page 78: lines 5, 12-13 and 17-18]

Under the OECD's Transfer Pricing Guidelines, the CRA's IC 87-2R and IRS' Internal Revenue Code, the primary test to determine whether a specific activity performed by a member of the multinational group for another member is a service for which a charge is justified is "whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself."[69]

If the activity is not one for which an independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered an intra-group service under the arm's length principle.

Activities that ordinarily would be considered intra-group services may include:

- Administrative services such as:
  - Planning,
  - Coordination,
  - Budgetary control,
  - Financial advice,
  - Accounting,
  - Auditing,
  - Legal,
  - Factoring, and
  - Computer services;
- Financial Services such as:
  - Supervising cash flows and solvency,
  - Capital increases,
  - Loan contracts,
  - Managing interest and exchange rate risks, and
  - Refinancing;
- Assistance in the fields of:
  - Production,
  - Buying,
  - Distribution, and
  - Marketing; and
- Services in staff matters such as:
  - Recruitment, and

[69] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.6. See also IC 87-2R, paragraph 162 and §1.482-9(1)(3)(i).

- Training.[70]

Similarly, an activity would not be considered an intra-group service if:

- It is classified as a Shareholder benefit;[71]
- It duplicates an activity that the recipient has already performed itself or had a third party perform on its behalf;[72] or
- If the benefit results from the recipient's status as a member of a controlled group.[73]

Although it would also be unusual for a group member to incur a charge for a service performed by another member of the group if that activity is performed by the member itself or by an arm's length party on the member's behalf, in some cases there may be a valid business reason for duplicating a service.[74]

The following are examples of shareholder activity-related costs provided by the OECD:

- Costs related to the legal structure of the parent company itself, such as the parent's shareholder meetings, issuing shares in the parent company, stock exchange listing of the parent company, and costs related to the governance board;
- Costs related to the financial reporting or regulatory requirements of the parent company including the consolidation of the reports;
- Cost of raising funds for the acquisition of an interest in a business;
- Cost related to compliance of the parent company with the relevant tax laws; and
- Costs which are ancillary to the corporate governance of the multinational enterprise as a whole.[75]

C.2 Determining an Arm's Length Charge

[Unchanged]

Where a charge for a service is justified, the amount charged should be determined in accordance with the arm's length principle. Determining the arm's length price for a service should be considered from the perspective of both the supplier and the recipient of the service. The arm's length price will not only be a function of the cost incurred by the supplier providing the service, but also a function of the value of the service to the recipient and how much an arm's length entity would be prepared to pay for such the service in comparable circumstances.[76]

In its Transfer Pricing Guidelines, the OECD recommends two methods that, when applied correctly, result in an arm's length price for the provision of services.[77] These methods are the comparable uncontrolled price ("CUP") method and the cost plus method.[78] The United Nations and CRA endorse the use of these methods.[79]

For U.S. tax purposes, the arm's length price charged for rendering services to related parties must be determined under one of the following six methods listed in §1.482-9:

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[70] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.14. See also IC 87-2R, paragraph 162 and §1.482-9(1)(3)(i).
[71] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.9 and OECD BEPS Public Discussion Draft, page 8.
[72] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.11 and OECD BEPS Public Discussion Draft, page 8.
[73] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.13 and OECD BEPS Public Discussion Draft, page 9.
[74] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.11.
[75] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.1, paragraph 7.10 and OECD BEPS Public Discussion Draft, page 8. See also IC 87-2R, paragraphs 156 and 157, and §1.482-9(l).
[76] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.3, paragraph 7.29 and IC 87-2R, paragraph 162.
[77] See "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators," OECD.
[78] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.3., paragraph 7.31.
[79] See IC 87-2R, paragraphs 160 and 162.

- Service cost method;
- Comparable uncontrolled services price method;
- Gross service margin method;
- Cost of services plus method;
- Comparable profits method; and
- Profit split methods.

Each method must be applied in accordance with the provisions of §1.482-1, including the best method rule, the comparability analysis, and the arm's length range.

These methods endorsed by the OECD, the UN, the CRA and the IRS, can be generally categorized into methods that evaluate the actual price of a service (the "comparable price methods") and methods that are based on the recovery of costs incurred by the service provider, plus a mark-up, if appropriate ("cost recovery methods").

C.2.1 Comparable Price Methods

[Unchanged]

Comparable price methods compare the price charged for services rendered between related parties in controlled transactions to the price charged for services rendered between unrelated parties in uncontrolled transactions in similar circumstances.[80] Evidence that would permit the application of the comparable price methods may arise where:

- The taxpayer or another member of the group receives or renders a service of substantially the same quality, in similar quantities and under comparable terms from/to arm's length parties in similar markets (internal comparable uncontrolled transactions); or
- An arm's length party receives or renders a service of substantially the same quality, in similar quantities and under comparable terms to another arm's length party in similar markets (external comparable uncontrolled transactions).[81]

Accordingly, the comparable price methods are likely to be used where there is a comparable service rendered between third parties in the recipient's market, or by the related party providing the service to a third party in comparable circumstances.

The CRA believes that the CUP method provides the best evidence of an arm's length price because it focuses directly on the price of a transaction and requires a high level of comparability.[82]

Transactions may serve as comparable transactions despite the existence of differences between those uncontrolled and the controlled transactions, if the differences can be reasonably quantified and appropriate adjustments can be made to eliminate the effects of those differences.[83] However, at some point, the differences may become so significant that the CUP method cannot be relied upon to produce arm's length price and other transfer pricing methods may have to be considered.[84]

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[80] See OECD Transfer Pricing Guidelines, Chapter II, Section B, paragraph 2.13.
[81] See IC 87-2R, paragraphs 64 and 161.
[82] See IC 87-2R, paragraph 53.
[83] See IC 87-2R, paragraph 66.
[84] See IC 87-2R, paragraph 55.

C.2.2 Cost Recovery Methods

[Unchanged]

In cases where comparable price methods cannot be reliably applied, the OECD encourages taxpayers to consider alternative methods which involve identifying an appropriate cost of a service. Once an appropriate cost of rendering a service is identified, the taxpayer must determine whether that cost of service should be marked-up, and if so, by how much.

The cost of providing such services may be borne initially by the parent company or alternatively, by a specially designated group member or by any group member.[85]

Affiliate services can be charged out to the recipients using either the direct charge method or the indirect charge method. Under the direct charge method, an affiliate is charged based on the costs incurred for a specific, readily-identifiable service. Under the indirect charge method, an affiliate is charged based on an allocation of costs incurred for a central beneficial service.[86]

C.2.3 Determining the Cost Base

[Unchanged]

There is limited guidance provided in OECD's Transfer Pricing Guidelines and the CRA's IC-87-2R regarding which costs to take into account when determining the cost of rendering a service. However, the IRS' Internal Revenue Code defines total services cost as "*all costs of rendering those services.*"[87] The term "*all costs*" will generally include direct operating costs (*e.g.*, salaries and benefits) as well as indirect operating costs (*e.g.*, overhead), but will exclude non-operating costs, such as "*interest expense, foreign income taxes, or domestic income taxes*"[88] as well as "*shareholder costs.*"

C.2.4 Determining the Allocation Method

[Modified - Page 78: lines 17-20 and 22-23; and page 79: lines 4-10]

Once the cost base is determined, taxpayers are then encouraged to identify and remove from the cost base those costs that are attributable to services performed by one group member solely on behalf of one other group member.[89]

The remaining cost base is then allocated to the relevant service recipients to approximate the cost of service to those recipients. The guidance provided by the OECD in its Transfer Pricing Guidelines is limited. It states the allocation can be based on "*turnover, or staff employed, or some other basis.*" [90] The guidance provided by the CRA is also limited to the following:

> "*When choosing an allocator (e.g., sales, gross or operation profits, units used/produced/sold, number of employees, or capital invested), the taxpayer should consider the nature and use made of the service.*" [91]

Even the IRS provides limited guidance to taxpayers in terms of an appropriate allocation method.

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[85] See OECD Transfer Pricing Guidelines, Chapter VII, Section A, paragraph 7.2.
[86] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.2, paragraph 7.20-7.27.
[87] See §1.482-9(j).
[88] See §1.482-9(j).
[89] See OECD BEPS Discussion Draft, page 18.
[90] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.3,paragraph 7.25.
[91] See OECD Transfer Pricing Guidelines, Chapter VII, Section A, paragraph 7.2.

"*Any reasonable method may be used to allocate and apportion costs. In establishing the appropriate method of allocation and apportionment, consideration should be given to all bases and factors, including, for example, total services costs, total costs for a relevant activity, assets, sales, compensation, space utilized, and time spent.*"[92]

In the OECD BEPS Discussion Draft, the taxpayers are encouraged to select an allocation key that reflects the level of benefit expected to be received by each service recipient for each category of services rendered.[93] As a general rule the allocation key should reflect the underlying need for the particular service rendered. For example, the allocation key for services related to people might use each company's share of total group headcount; IT services might use the share of total users, fleet management services might use the share of total vehicles, accounting support services might use the share of total relevant transactions of share of assets. In other cases, the share of total sales may be the most relevant key.

C.2.5 Determining Whether a Mark-up Should Be Applied

[Modified - Page 81: lines 3-20]

Arm's length service providers would normally seek to charge a fee for their services in such a way so as to generate a profit, rather than merely charging for the service at cost. However, there are circumstances in which an arm's length party would not generate a profit from rendering a service. Accordingly, it need not always be the case that an arm's length price will result in a profit for an associated enterprise that is performing an intragroup service.[94]

The guidance provided by the CRA mirrors that of the OECD on this issue. According to the CRA, determining whether a mark-up is appropriate and, if so, the quantum of the mark-up requires careful consideration of the following factors:

- The nature of the activity;
- The significance of the activity to the group;
- The relative efficiency of the service supplier; and
- Any advantage that the activity creates for the group.[95]

With the exception of the services cost method, the methods by which the IRS determines arm's length amounts charged in affiliate services transactions include a profit element. The services cost method allows a zero mark-up. The services cost method may be applied if the following conditions are met:

- The service is a covered service;[96]
- The service is not an excluded activity;[97]
- The service is not precluded from constituting a covered service by the business judgment rule;[98] and

[92] See §1.482-9(k).
[93] See OECD BEPS Discussion Draft, page 18.
[94] See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.3, paragraph 7.33. In the context of determining whether to add a mark-up to a service-related cost transferred between related parties, the OECD distinguishes between situations in which one of the related parties renders the service and situations which one of the related parties involved acts solely as an intermediary on behalf of the other related party or parties to acquire services from an arm's length party. In the latter situation, the OECD suggests that it may be appropriate to pass on these costs to the group recipients without a mark-up because they are costs that the group recipients would have incurred directly had they been independent parties (See OECD Transfer Pricing Guidelines, Chapter VII, Section B.2.3, paragraph 7.36). The CRA provides similar guidance on the issue of flow-through costs (See IC 87-2R, paragraphs 165).
[95] See IC87-2R, paragraph 164.
[96] See §1.482-9(b)(3).
[97] See §1.482-9(b)(4).
[98] See §1.482-9(b)(5).

- Permanent books of account and records are maintained for as long as the costs with respect to the covered services are incurred by the renderer.[99]

Many tax administrators consider the value of the service being rendered to determine whether a cost of service should be marked-up. In general, tax administrators have historically permitted mark-ups on value-added activities and denied mark-ups on routine activities. This has been a contentious issue amongst tax administrators. In the OECD BEPS Discussion Draft, the OECD has proposed a simplified approach to for determining the amount to be charged and paid for by individual members of a multinational enterprise for low value-adding services based on the costs incurred to render the service plus a mark-up between 2 percent to 5 percent. The services identified by the OECD that would likely meet the definition of low value-adding services included:

- Accounting and audit activities;
- Processing and management of accounts receivable and accounts payable;
- HR activities;
- Monitoring and compiling date related to health, safety environmental and other standards regulating the business;
- Information technology services, that are not part of the principal activity of the group;
- Internal and external communications and public relations support, excluding specific advertising and marketing activities;
- Legal services;
- Tax activities; and
- Administration support.

[99] See §1.482-9(b)(6).

Appendix D: Country Survey of Allocation Methods for Intra-group Services

D.1 Introduction

[Modified - Lines 1-2]

Grant Thornton surveyed its member firms to gain an understanding of the cost allocation methods used in 80 countries. These allocation methods pertain to the allocation of centralized or cross-border intra-group services rendered to related multinational enterprises. Using the responses from these member firms, Grant Thornton has prepared the following summary of global best practices.

D.2 Organisation of Economic Cooperation and Development

[Unchanged]

The OECD has published guidelines to assist multi-national enterprises and tax administrations with respect to the pricing and evaluation of cross border intercompany transactions.[100] The OECD relies on the use of the arm’s length principle to put “associated and independent enterprises on a more equal footing for tax purposes”[101] and “promote the growth of international trade and development”[102]. The CRA’s views reflect that of the OECD's Transfer Pricing Guidelines. In paragraph 7.25 of the OECD's Transfer Pricing Guidelines, the OECD states that an appropriate allocation should consider the nature and usage of the service being rendered. Potential allocation keys are number of staff for the provision of payroll and number of group members for expenditure on computer equipment.

[100] See to Organisation for Economic Cooperation and Development’s *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2010)*.

[101] See OECD's Transfer Pricing Guidelines, Chapter I, ¶ 1.8.

[102] See OECD's Transfer Pricing Guidelines, Chapter I, ¶ 1.8.

D.3 Survey Responses by Country

D.3.1 Algeria

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: There is no specific guidance or rules issued by the Algerian tax authority.

D.3.2 Argentina

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: There is no specific guidance or rules issued by the Argentinian tax authorities. There is no reference in Argentinian law to the OECD rules. However, the OECD's Transfer Pricing Guidelines are generally accepted as a reference, but the situations are analyzed by the Argentinian tax authorities on a case-by-case approach.

D.3.3 Armenia

[Modified - Line 12]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Armenia currently does not have transfer pricing legislation.

D.3.4 Australia

[Modified - Line 16]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: There are no guidelines issued by the tax authority Australian Taxation Office ("ATO"), Taxation Ruling TR 1999/1: Whether a multinational enterprise ("MNE") uses either a direct or indirect method of charging for services, to conform with the arm's length principle, the charge used for tax purposes should be the best possible approximation of the arm's length consideration for those services. It is recognized by the ATO that choosing an allocation method to estimate the shares of expected benefits is a matter of judgment. It is required that taxpayers put forth their best effort to apply an indicator that approximates the expected sharing of benefits in the particular circumstances faced at the time the service is provided. Determining whether the allocation key is appropriate depends on the nature and usage of the service. Some keys may be suitable for more than one type of service and the total amounts to be allocated in respect of several services may be able to be allocated with the one key.

D.3.5 Austria

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.6 Belgium

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The Belgium tax authorities have not published any specific guidance in the context of cross-border intra-group services. Generally speaking, the Belgian tax authorities will accept OECD's Transfer Pricing Guidelines.

D.3.7 Brazil

[Modified - Lines 11-15]

OECD Country: No.

Method of Allocation: Reasonable allocation.

Additional Commentary: The Brazilian transfer pricing rules do not follow the international standards (OECD Transfer Pricing Guidelines or U.S. transfer pricing laws), nor does the Brazilian tax authorities publish specific guideline regarding metrics. The definition in Brazilian law for allocations is that it should be reasonable and consider the nature of the expenses that will be allocated. However, no definition of reasonability is provided in the Brazilian law.

D.3.8 Bulgaria

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The Bulgarian tax authorities issued a transfer pricing manual, which is analogous to the OECD's Transfer Pricing Guidelines.

D.3.9 Canada

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The CRA administers tax law in Canada. Canadian transfer pricing law is legislated in Section 247 of the the Act. Section 247 of the Act focuses exclusively on transactions that occur between the taxpayer and a non-resident party with whom the taxpayer does not deal at arm's length. Transfer pricing legislation in Canada does not provide guidance with regards to a specific set of allocation keys to apply when determining the cost allocations between related parties for shared services. However, the CRA has published IC87-2R which documents CRA's views with respect to the interpretation of Section 247 of the Act. In paragraph 171 of IC 87-2R the CRA states that the taxpayers should consider the nature of the services when allocating costs to related parties for shared services. In the same paragraph, the CRA also provides the taxpayer with the following potential allocation keys: sales, gross or operating profits, units used/produced/sold, number of employees, or capital invested. IC87-2R is not the law, but rather a source of information with respect to the policies behind the Act and the application of the transfer pricing rules. As a result, the courts are not bound by the legislations or policies published by the CRA and the courts are free choose their own interpretation.

D.3.10 Cayman Islands

[Unchanged]

OECD Country: No.

Method of Allocation: The Cayman Government gives no guidance on allocations. There are no Income taxes, corporate taxes, succession duties or Property taxes in the Cayman Islands.

Additional Commentary: The Cayman Islands is not a tax haven, since duties are paid on everything that is brought into the islands. Only regulated companies require an audit; all other companies do not require an audit, nor are they required to file financial statements.

D.3.11 Guernsey

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Guernsey does not have transfer pricing rules. The Guernsey tax authority follows the OECD model as a basis for groups involving other territories.

D.3.12 Chile

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.13 China

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: China has not published any ruling specifically for the allocation key of service cost base. In practice, the OECD approach is followed and tax authorities would normally assess the reasonableness of the proposed allocation key based on the service nature.

D.3.14 Croatia

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The tax treatment of the cross-border intra-group services in Croatia is regulated by the Corporate Tax Act and Rules on the Corporate Income Tax. There is no detailed guidance on transfer pricing issue provided by the Croatian tax authority, but generally, OECD Directive on transfer pricing is applied. The methods described and the preferences of the methods are the same as described in the OECD's Transfer Pricing Guidelines.

D.3.15 Cyprus

[Unchanged]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: Refer to Section 33 of The Income Tax Laws (2002) for transfer pricing rules.

D.3.16 Czech Republic

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Guideline D-332, issued by the Ministry of Finance of the Czech Republic, ref. no.: 39/86 829/2009-393, Financial Bulletin 6/2010 dated December 1, 2010, summarizes the transfer pricing legislation and defines the application of principles listed in the OECD's Transfer Pricing Guidelines for conditions in the Czech Republic. It ensures unified approach to the taxation of transfers between associated enterprises for both tax administrators and tax subjects.

D.3.17 Denmark

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.18 Estonia

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.19 Finland

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.20 France

[Modified - Line 13]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The French tax authority relies on guidance from the OECD's Transfer Pricing Guidelines and the European Union ("EU") Joint Transfer Pricing Forum guidelines on low value added intra-group services. There are no French regulations, guidance or Supreme Court Cases specific to the allocation of inter-company service charges other than general deductibility rules. These general deductibility rules state that services must be effectively needed and used by the recipient (benefit test) and corresponding charges must be arm's length. From the French Tax Administration's interpretation of OECD and European Union guidelines, the following practices apply:

- Where no direct allocation of specific services to particular recipients is workable, sharing a cost base through the use of relevant allocation keys is possible;
- Allocation keys must reflect the economic nature of the service (e.g., headcounts for HR services, users/log ins for IT, turnover for sales administration);
- The use of only one allocation key (e.g., turnover for a bundle of services different in nature is not recommended);
- The results of the allocations must be consistent and proportionate with expected benefits; and
- The arm's length principle generally requires a mark-up.

D.3.21 Georgia

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In Georgia, the regulation of issues related to transfer pricing has been adopted only recently (December 2013) and is generally based on the OECD's Transfer Pricing Guidelines.

D.3.22 Germany

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: German rules are based on the OECD's Transfer Pricing Guidelines. The rules are provided in a decree of the German tax authorities (3.2 Apportionment Formula):

- The formula that is most appropriate in the individual case must be selected. Where two or more formulas are equally appropriate, the management has discretion in selecting the formula.
- The factors on which the standard of apportionment may potentially be based include without limitation the following: unit quantities used, manufactured, sold, or anticipated in a line of products; cost of materials; machine hours; number of employees; total payroll amount; value added; capital invested; operating profit; and sales revenue.
- Other factors may be appropriate under the circumstances of the specific case. For instance, a multi-factor formula may be appropriate where different factors are weighted for apportionment purposes.

D.3.23 Gibraltar

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In Gibraltar, there is no specific case law or guidelines issued by the tax authority with respect to allocation keys or metrics in the context of cross-border intra-group services. The Gibraltar Commissioner of Income Tax will only accept that a payment to a connected party is at arm’s length if he is convinced that the payment in respect of a specific product or service and that the amount paid has been computed in accordance with OECD transfer pricing principles. Accordingly, Gibraltar would follow OECD's Transfer Pricing Guidelines, Chapter VII (Intra-group Services).

D.3.24 Greece

[Modified - Lines 3-4]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: New transfer pricing provisions were introduced by Law 4110/2013 which amends Law 2238/1994.

D.3.25 Guatemala

[Modified - Line 6]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.26 Hong Kong

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Hong Kong's Departmental Interpretation and Practice Notes No. 46 Transfer Pricing Guidelines - Methods and Related Issues, states that when determining whether the amount of the charge is in accordance with the arm's length principle, both the basis of charging and an appropriate margin must be determined. The OECD Transfer Pricing Guidelines suggest two main methods: the direct charge method and the indirect charge method. Charges could be calculated on the basis of head count (for HR costs), turnover (for marketing costs), number of computer terminals in use (for IT support), etc.

D.3.27 Hungary

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In general Hungarian legislation follows OECD's Transfer Pricing Guidelines. According to Hungarian law (Act on Corporate Income Tax and a Finance Ministry), low value added services can consist of the following:

- IT services (codes according to the classification of products by activity: 62.01, 62.02, 62.03, 62.09, 63.11);
- Real property management (68.32);
- Legal, accounting activity, translation, interpretation, market research (69.10, 69.20, 74.30, 73.20);
- Education (85.59, 85.60);
- Administration services (82.1, 53.20);
- Transportation, forwarding, cargo handling, warehousing, storage (52.10, 49.41, 52.2); and

- Accommodation service (55.9), canteen service (56.29.2) and safe-guarding services (80.10.12).

D.3.28 Iceland

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: There is no any legislation, case law, or guidelines that specifically relate to allocation keys or metrics in the context of cross-border intra-group services issued by the tax authority in Iceland. Even though there is no guidance published, and no specific transfer pricing rule in force, the OECD's Transfer Pricing Guidelines may serve for purpose of interpreting the general arm’s length principle under the Icelandic tax act, in cross-border-cases, but it does not have direct legal effect in Iceland. A general arm’s length principle is applicable under the Icelandic law, with regards to cross-border-cases.

D.3.29 Indonesia

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: There is no specific guidance on the determination of allocation keys to review cross-border intra-group services. However, the guidance on how the tax office should conduct transfer pricing audit suggests that the Indonesian tax office adopts Chapter VII of the OECD TP Guidelines when reviewing the intra-group services. The audit guidelines on intra-group services suggest that the taxpayer should use allocation keys which is appropriate for the nature and type of services rendered. For more information refer to the Director General of Taxation Regulation no. PER - 22/PJ/2013 and Director General of Taxation Circular no. SE - 50/PJ/2013.

D.3.30 Iran

[Unchanged]

OECD Country: No.

Method of Allocation: Arm’s length principle.

Additional Commentary: Except for a few treaties for avoiding double taxation, there are no specific regulations in the Iranian tax code regarding transfer pricing. However, there is a good amount of discussion, number of circulars, etc. by the Iranian Ministry of Finance in this respect. The Iranian Ministry of Finance emphasizes "common international practice" which is analogous to conducting transactions on an arm's length basis.

D.3.31 Ireland

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Ireland has not published specific guidance in relation to intra-group services. There is a publication from the EU Joint Transfer Pricing Forum guidelines on low value adding intra-group services and as Ireland is part of the EU it would be expected to follow these rules along with the OECD’s Chapter VII - Intra group services. EU Joint Transfer Pricing Forum guidelines outlines that no matter which approach or allocation method is chosen, it “must be capable of being justified and applied consistently”.

D.3.32 Israel

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Transfer pricing rules in Israel are generally based on both the OECD's Transfer Pricing Guidelines and the U.S. Transfer Pricing Regulations. The Israel tax authorities recommend that the tax payer perform a benefit test while also applying the arm's length principle to determine an appropriate allocation key.

D.3.33 Italy

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: According to Inland Revenue (Circular dated 09.22.1980 n. 32 - Min Finance - Direct Taxes): “usually the consideration, or better, the participating “quota” of each associated company [to cost sharing arrangements] is pre-established according to fixed formulas based on the ratio between the turnover of the recipient and the total turnover of the Group, or on other parameters (invested capital, number of employees, operating capacity, etc.).”

D.3.34 Jamaica

[Unchanged]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: Jamaica has no transfer pricing rules. However, Jamaica does have anti-avoidance rules that seek to ensure that transactions between related parties are conducted at arm's length values and do not have tax avoidance as a primary purpose. Section 17 of the Income Tax Act states that: 17. (1) Where the Commissioner is of the opinion that (a) any transaction carried out between connected persons was carried out for a consideration substantially different from that obtainable at arm's length or for no consideration; and (b) the effect of this would be to reduce the amount of tax payable by any person, the Commissioner may, for the purposes of that person's tax liability, treat the transaction as having been carried out for such consideration as would in his opinion have been obtainable at arm's length: Provided that this subsection shall not apply if that person shows to the satisfaction of the Commissioner that - (i) the transaction did not have as its object, or one of its objects, the avoidance of tax; and (ii) the consideration for which the transaction was carried out was of a value not less than the cost incurred by the person receiving the consideration in providing the subject matter of the transaction (including a reasonable sum for overheads). (2) Without prejudice to subsection (1), where the Commissioner has reason to believe that any transaction carried out for a consideration substantially different from that obtainable at arm's length, or for no consideration, was so carried out with the object of reducing the amount of tax payable by any person, or for purposes including that object, he may treat the transaction as having been carried out for such consideration as could in his opinion have been obtainable at arm's length.

D.3.35 Japan

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: There are no official guidelines provided by the Japanese tax authority regarding allocation keys or metrics for inter-company services. However, Japanese transfer pricing rules (Commissioner's Directive on the Operation of Transfer Pricing (Administrative Guidelines) National Tax Agency of Japan) are in line with the OECD's Transfer Pricing Guidelines.

D.3.36 Kazakhstan

[Unchanged]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: Kazakhstan has a law on Transfer Pricing, which regulates public relations, subject to transfer pricing for preventing state revenue deprivation with respect to international business deals. However, in the presence of ratified international agreement provisions of which stipulate different approach, the provisions of the latter shall be followed. The Law determines the methods for defining the market price, provides definition of related parties and "arm's length" principle and others.

D.3.37 Kenya

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In Kenya, the Income Tax legislation does not provide for allocation of keys or metrics for cross-border intra-group services. Given that there is no provision in the Kenyan legislation for this, the Kenyan tax authorities will generally follow OECD's Transfer Pricing Guidelines, Chapter VII (Intra-group Services).

D.3.38 Korea

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: According to the Law for Coordination of International Tax Affairs ("LCITA") of Korea, where the price for a transaction of service deemed necessary for business management, financial advertising, payment guarantee, support to an electronic system or technical support, or any other service between a resident and a foreign related party is the one for a transaction of service that meets all of the following requirements, such a price shall be deemed as the arm's length price.

- The service provider shall make an agreement in advance and actually provide such a service in accordance with the agreement;
- There shall exist an additional benefit or a reduction in expenses, which the person who has such service provided expects from the service;
- The price for the service provided shall be computed in an arm's length principle; and
- There shall be proper documents prepared and preserved for providing the relevant facts.

It also states that in case the services are actually provided in accordance with the aforementioned article, it should be supported with the relevant data such as work schedule of service provision, table showing progress of service provision, information on the service provider and its employees, details of the expenses incurred, etc.

D.3.39 Liechtenstein

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Liechtenstein has no formal transfer pricing legislation or documentation requirements, although all related party transactions with Liechtenstein entities must be carried out on arm's length terms; Since 2011 the Liechtenstein Tax Act includes expressis verbis the arm's length principle in article 49; Further, Liechtenstein follows the OECD transfer pricing guidelines; As Liechtenstein adheres to the OECD transfer pricing guidelines it also applies the respective methods proposed therein; Regarding transfer pricing allocation methods the Liechtenstein Tax Authority does apply the Swiss standards.

D.3.40 Lithuania

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Lithuania has no transfer pricing legislation, case law or guidelines with respect to allocation keys or metrics issued by the tax authority in Lithuania.

D.3.41 Luxembourg

[Modified - Line 9]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In Luxembourg, there is no transfer pricing legislation, with the exception of intragroup financing activities (i.e., Luxembourg companies in back to back arrangement). For the other matters, the Luxembourg tax authority generally refers to the OECD Guidelines without any specific provisions implementing them in the Luxembourg law.

D.3.42 Macedonia

[Modofied - Line 15]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: Macedonian law states that the taxpayer, at the request of the tax authority, should present sufficient information and analysis to confirm the terms of transactions between related parties under the arm's length principle. The Macedonian tax authority will refer to the OECD Guidelines for all situations that are not considered and covered with the explanations provided in the Macedonian law. More information can be found in the Corporate Income Tax Law (Official Gazette of RM No. 80/1993…79/2013) and the Rule Book on the manner of calculation and payment of the Corporate Income tax and avoidance of double taxation relief or double taxation (Official Gazette of RM No. 173/2011).

D.3.43 Malaysia

[Modified - Line 22]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Malaysian transfer pricing guidelines state that an allocation key must be appropriate to the nature and purpose of service rendered, which is similar to the OECD's Transfer Pricing Guidelines.

D.3.44 Malta

[Unchanged]

OECD Country: No.

Method of Allocation: No transfer pricing legislation.

Additional Commentary: Malta does not have transfer pricing legislation though there are general anti-avoidance rules which stipulate that the Commissioner may ignore any transaction which is artificial and entered into with the sole purpose of reducing taxation. However, this provision has rarely been enforced, with the exception of transactions relating to immovable property situated in Malta.

D.3.45 Mexico

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.46 Moldova

[Modified - Lines 13-14]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: The Moldovan tax law does not provide any transfer pricing documentation requirements. However, the tax authorities envisaged the introduction of formal transfer pricing requirements in the Moldovan tax law starting in 2015. No announcements have been made yet. Transactions between co-owners or interdependent persons can be taken into account provided that the respective interdependence has not influenced the outcome of the transaction. It is important to mention that transactions carried out between related parties should observe the arm's length principle, whereas transactions that do not follow this rule may be disregarded for tax purposes. Moreover, in cases where the tax authorities determine (based on documented evidence) that the company has delivered/supplied goods/services at a price lower than the market value, the company will be required to compute addition VAT on the difference between the market value and the respective selling price.

D.3.47 Morocco

[Modified - Line 25]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In Morocco, there are no specific transfer pricing regulations. Morocco follows the regulatory framework presented in the OECD Guidelines.

D.3.48 Mozambique

[Modified - Lines 4- 5]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The Mozambican Tax Authority does not issue specific guidelines or legislation in relation to allocation keys or metrics. Mozambique has a very basic transfer pricing regime and is based on the arm's length principle and the OECD's Transfer Pricing Guidelines.

D.3.49 Namibia

[Modified - Line 7]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The Namibian tax authority refers to the OECD guidance and arm's length principle. For more information refer to Section 95A in the Namibian Income Tax Act.

D.3.50 Netherlands

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The Netherlands follow Chapter VII of the OECD's Transfer Pricing Guidelines. Especially 7:20 through 7:28: "The allocation might be based on turnover, or staff employed, or some other basis. Whether the allocation method is appropriate may depend on the nature and usage of the service."

D.3.51 New Zealand

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: New Zealand Inland Revenue fully endorses the positions set out in chapters 1 to 8 of the OECD's Transfer Pricing Guidelines and proposes to follow those positions in administering New Zealand's transfer pricing rules. Consequently, New Zealand's guidelines should be read as supplementing the OECD's Transfer Pricing Guidelines, rather than superseding them. There are a number of allocation keys that might be applied to allocate costs between members of a group. The OECD's Transfer Pricing Guidelines, for example, make reference to allocation keys based on turnover, staff employed, and capital applied (paragraph 7.25).

D.3.52 Norway

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: None.

D.3.53 Philippines

[Unchanged]

OECD Country: No.

Method of Allocation: Determined based on the nature of the service.

Additional Commentary: There is neither specific reference to the inter-group services chapter of the OECD's Transfer Pricing Guidelines but there is an end-note in the guidelines that the OECD's Transfer Pricing Guidelines may be referred to for guidance and examples. Revenue Regulations No. 2-40, as amended by Revenue Regulations No. 16-86 on the allocation of Head Office expenses to branches:

- Gross income from sources within the Philippines to the total gross income.
- Net sales in the Philippines to total net sales.
- If any other method of allocation is adopted, a written permission from the Commissioner of Internal Revenue shall first be secured.

Revenue Audit Memorandum Order No. 01-98 (July 7, 1998) providing for the Audit Guidelines and Procedures in the Examination of Interrelated Group of Companies has the following provisions in relation to cost-sharing arrangements: 3.4.2 In determining the appropriateness of the sharing arrangement, factors such as benefits-received, size of the company, participation in the venture, and etc. should be considered.

D.3.54 Poland

[Modofied - Line 27]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Polish transfer pricing regulations do not provide any direct guidelines with respect to the allocation costs in cross-border intra group-services. Furthermore, domestic tax authorities haven't issued any guidelines in that scope so far. An allocation key shall directly reflect the benefits achieved by each recipient of the services. Forum performed in the period April 2009 to June 2010, Point 53 of the communication determines the following allocations keys in the context of the low-value added services:

- IT: number of PCs,
- Business management software (e.g., SAP): number of licenses,
- HR: headcount,
- Health and safety: headcount,
- Management development: headcount,
- Tax, Accounting, etc.: turnover or size of balance sheet,

- Marketing services: turnover,
- Vehicle fleet management: number of cars.

D.3.55 Portugal

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Portugal does not have specific legislation, case law, or guidelines issued by the tax authority with respect to allocation keys or metrics in the context of cross-border intra-group services.

D.3.56 Puerto Rico

[Unchanged]

OECD Country: No.

Method of Allocation: Arm’s length principle.

Additional Commentary: Puerto Rico has not published specific guidelines on transfer pricing and does not necessarily follow OECD's Transfer Pricing Guidelines. Law § 30179 (2011-PRIRC 1040.09) & Reg. § 1047-2: states that the tax authorities support the Arm's Length Principles.

D.3.57 Qatar

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Qatar has not yet published specific guidance regarding transfer pricing and it is generally follow OECD's Transfer Pricing Guidelines.

D.3.58 Romania

[Modified - Lines 19-20]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Romanian transfer pricing legislation does not include specific guidelines with respect to allocation keys or metrics. Romania follows the provisions of the OECD's Transfer Pricing Guidelines in respect of intra-group services and allocation keys on a case-by-case basis.

D.3.59 Russia

[Modified - Line 6]

OECD Country: No.

Method of Allocation: Russian transfer pricing legislation is based on OECD approach.

Additional Commentary: Russia is not currently an OECD member and the OECD's Transfer Pricing Guidelines (and in particular Chapter VII (Intra-group Services) is not applicable in Russia. Although Russian transfer pricing legislation is based on the OECD's approach, there is no guidance with regards to special cost allocation principles for intra-group services. In other words, there are not any special transfer pricing law provisions to be used in the context of cross-border intra-group services (in particular with regard to indirect-charge methods). It is also necessary to note that the Russian tax authorities usually pay great attention to economical feasibility and documental support of the intra-group services provided (this is relevant for expenses deductibility purposes).

D.3.60 Saudi Arabia

[Unchanged]

OECD Country: No.

Method of Allocation: Fair market value.

Additional Commentary: There are no detailed transfer pricing rules in Saudi Arabia. In the absence of such transfer pricing rules, the Saudi Tax authority generally accept a price if they are satisfied that it represents a fair market value of the subject services or supplies. Transaction between related parties must be conducted on the basis that the parties are independent. The lack of specific transfer pricing rules unfortunately provides wide powers to the Saudi Tax authority to accept or reject any particular pricing mechanism.

D.3.61 Serbia

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Serbia's transfer pricing rulebook has been created in accordance with OECD's Transfer Pricing Guidelines. First transfer pricing guideline (statutory act) proclaimed at the end of 2013. The rulebook (10 pages) includes rules about proposed basic methods. 2013 will be first year that must be covered by transfer pricing study. The Serbian tax authorities will refer to the OECD's Transfer Pricing Guidelines in case of any misunderstanding.

D.3.62 Singapore

[Unchanged]

OECD Country: No.

Method of Allocation: Gross sales, income or receipts, loans and deposits, staff numbers, floor area and asset size, etc.

Additional Commentary: The Singapore transfer pricing guidelines and circulars are generally consistent with the OECD's Transfer Pricing Guidelines. However, there are some differences between the OECD's Transfer Pricing Guidelines and those in the IRAS supplementary circular on "Transfer Pricing Guidelines for Related Party Loans and Related Party Services". These differences are: services provided by a Singapore taxpayer in a cost pooling arrangement should not be its principal activity. Services are considered its principal activity if the costs relating to the provision of the service exceed 15% of its total expenses in the financial year; and cost pooling can only be used for "routine" services. IRAS Supplementary e-Tax Guide Section, Transfer Pricing Guidelines For Related Party Loans and Related Party Services 3.3.4 states that the Indirect charge methods entail the use of an appropriate apportionment basis/allocation keys to charge/bill for the service provided, such as gross sales, income or receipts, loans and deposits, staff numbers, floor area and asset size, etc.

D.3.63 Slovak Republic

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Slovakia in general follows OECD's Transfer Pricing Guidelines, Chapter VII (Intra-group Services).

D.3.64 Slovenia

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Slovenia has no legislation, case law, or guidelines have been issued by the tax authority with respect to allocation keys or metrics.

D.3.65 South Africa

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: South Africa has no specific method of allocation and does not yet have any Transfer Pricing related case law. However, Practice Note 7 of 1999 to the Income Tax Act does provide support to follow the OECD's Transfer Pricing Guidelines: 18. Intra-group Services 18.1 Chapter VII of the OECD's Transfer Pricing Guidelines deals specifically with intra-group services. The Commissioner considers the guidance provided in that chapter relevant and recommends that taxpayers follow the guidance in establishing arm’s length conditions in international agreements with connected persons involving intra-group services.

D.3.66 Spain

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Spain’s tax authority does not provide examples or any allocation key. However, Spain’s legislation states that companies should follow rationale criteria. The nature of the services, the circumstances and the benefices should be taken into account in order to fulfil with the rationale criteria.

D.3.67 Sweden

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Sweden does not have any specific regulations on allocation keys.

D.3.68 Switzerland

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Switzerland has no formal transfer pricing legislation or documentation requirements, although all related party transactions with Swiss entities must be carried out on arm’s length terms. In general, Switzerland follows the OECD's Transfer Pricing Guidelines (exception for interest rates on loans granted to or from shareholders or related parties). Since Switzerland adheres to the OECD's Transfer Pricing Guidelines it also applies the respective methods proposed therein. Based on current Swiss tax practice, the profit margin for service companies must be determined in accordance with the arm’s length principle, and thus, each taxpayer must consider an appropriate margin on the basis of comparable uncontrolled transactions. The Swiss Federal tax authorities imply that the cost plus method is the most appropriate method for service companies to price their services based on functional and risk analysis. In general, a full cost approach is applied (including all direct and indirect costs). Typically, the profit margin for such services is 5% - 10% which is preferably substantiated by a transfer pricing documentation. The taxpayer may prove that the actual margin is lower by appropriate documentation in line with the OECD's Transfer Pricing Guidelines. For financial and management services the cost plus method is accepted in exceptional cases only. Switzerland generally follows the OECD's Transfer Pricing Guidelines, and thus, also on chapter VII (intra-group services).

D.3.69 Taiwan

[Unchanged]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: Taiwan's tax authority stats that allocation methods should be based on a reasonable approach. For more information refer to Article 19 and 20 of Regulations Governing Assessment of Profit-Seeking Enterprise Income Tax on Non-Arm's-Length Transfer Pricing (2004.12.28 Announced). In Taiwan, allocations based on percentage of total sales are the most common method used.

D.3.70 Thailand

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Thailand does not have a specific guideline on the allocation keys. Thailand generally follows the OECD's Transfer Pricing Guidelines. If it relates to IT services costs, the Thailand tax authority will recommend using the number of users as a base. For allocating costs based on revenue (and others), you have to ensure that there are very clear pieces of evidence showing that the Intra-group Services benefited the Thai subsidiary, that the services provided included the Thai subsidiary, and the expenses were incurred for the purpose of generating a profit for the business in Thailand. If not, the allocated intra-group cost will be disallowed as a deductible expense in Thailand. Thailand is a Civil law country. Thus, case law generally does not stand before the Court.

D.3.71 Turkey

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Guidance provided by Turkey's tax authority states that "In conformity with the arm's length principle, in determining whether the intra-group service is rendered, it shall be considered whether a commercial or economic value strengthening the commercial position of the group company buying the service is provided or not. Where a related company buys an unneeded service from the parent company or from another company of the group companies or when a service is rendered to any group company just because of its being one of the group companies, it is not acceptable that the company in question gets intra-group service." For more information refer to the "Disguised Income" notion included in the repealed Corporate Tax Law No. 5422, and article 13 of the Corporate Tax Law No. 5520.

D.3.72 Uganda

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Uganda generally relies on OECD's Transfer Pricing Guidelines.

D.3.73 Ukraine

[Modified - Lines 5-8]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: In September 2013, a Law of Ukraine "On the Amendments to the Tax Code of Ukraine Regarding Transfer Pricing" became effective, introducing enhanced transfer pricing rules, which are generally in line with the OECD's Transfer Pricing Guidelines, but with some specific local rules.

D.3.74 United Arab Emirates

[Unchanged]

OECD Country: No.

Method of Allocation: No transfer pricing legislation in place.

Additional Commentary: The United Arab Emirates is a tax free country and therefore has no transfer pricing legislation in place.

D.3.75 United Kingdom

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The United Kingdom tax authorities state that, if possible, a direct charge method should be used, relating to the provision of the service to each recipient. If this is not practicable, then it may be necessary to use an indirect charge method (i.e., to use an allocation key that provides a reasonable proxy for the sharing out the value of the service). For example, if the level, intensity, type and quality of service delivered to different recipients is similar and the volume of service correlates relatively well with the benefit derived by the service recipients, then each recipient's share of the volume of service delivery could be used to allocate the total cost and mark up between service recipients.

D.3.76 United States

[Unchanged]

OECD Country: Yes.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: The U.S. regulations 1.482-9 state that any reasonable method may be used to allocate and apportion costs under this section. In establishing the appropriate method of allocation and apportionment, consideration should be given to all bases and factors, including, for example, total services costs, total costs for a relevant activity, assets, sales, compensation, space utilized, and time spent.

D.3.77 Uruguay

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Uruguayan transfer pricing regulations do not contain any provisions or guidelines regarding allocation keys and generic tax regulations do not contain any such provisions or guidelines either. Regulations are very similar to the Argentinean regulations and follow the OECD's Transfer Pricing Guidelines in most aspects. There is a ruling of the tax authority (Consulta 5.214), in which a taxpayer made the following query to the tax authority; the parent company of the Uruguayan branch hired technical services related to several works, among them works performed in the Uruguayan office. The parent company then invoiced the expenses to the Uruguayan branch. The branch's query was if the allocation key of such expenses could be the hours destined to the Uruguayan project. The tax authority answered that such criterion would be technically acceptable as long as it reflects the effective services rendered to the branch.

D.3.78 Uzbekistan

[Unchanged]

OECD Country: No.

Method of Allocation: Arm's length principle.

Additional Commentary: Transfer pricing laws in Uzbekistan are set forth by the Uzbek Tax Code. An extract from Tax Code, Article 40: If related parties use in their commercial and financial operations prices different from than third parties, in determination of taxable object (entity), taxable base computed for selling goods and services, state tax authorities use prices which are used/applicable for third parties (arm's length transaction principle will be applied according to the Tax code).

D.3.79 Vietnam

[Modified - Lines 10-13]

OECD Country: No

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines

Additional Commentary: In the case of intra-group services in Vietnam, allocation methods are not supported within domestic transfer pricing regulations. Vietnam is not an OECD member, though it often follows OECD guidance and it is party to tax treaties with several OECD members. Additional guidance is provided by the Ministry of Finance through the General Department of Taxation: Circular No. 66/2010/TT-BTC.

D.3.80 Zimbabwe

[Unchanged]

OECD Country: No.

Method of Allocation: Generally follows the OECD's Transfer Pricing Guidelines.

Additional Commentary: Zimbabwe has not published any rules or regulations regarding transfer pricing. Zimbabwe has anti-avoidance legislation and to a large extent follows the OECD's Transfer Pricing Guidelines.

D.4 Summary of Survey

[Modified - Lines 5-9]

The results of Grant Thornton's survey indicated that 75 of the 80 countries that participated, generally follow the OECD's Transfer Pricing Guidelines or the arm's length principle. Of the remaining 5 countries, 2 do not have transfer pricing legislation and the remaining 3 countries base their transfer pricing methods on the following factors:

- A reasonable allocation depending the nature of the service, which is analogous to the OECD's guidance;
- Gross income or net sales, which is consistent with the examples provided by Canada, France, Germany, and United States; and
- Staff numbers and asset size, which is consistent with the examples provided by the OECD's Transfer Pricing Guidelines.

Appendix E: Listing of the Components for the Bill Rate

E.1 Operating Bill Rate

[Modified - Section heading, lines 1 and 4, and Table 32 heading]

The components of the operating bill rate are as follows:

- Salary cost components:
  - Salaries & Temporary Salaries including the payroll code for Easeback/Return to Work
  - Other Salary Costs - Retroactive Pay
- Mark-up components, as presented in Table 32

Table 29 - Newfoundland and Labrador Hydro
Mark-up Components of the Operating Bill Rate
November 10, 2014

Fringe Benefit Costs	Insurances	Company Costs	Leave
Canada Pension Plan	Life Insurances	Payroll Taxes	Training Hours
Employment Insurance	A D&D Insurance	Bonus	Short-Term Sick Leave
Public Service Pension Plan	Medical Insurance	Performance Contracts	Long-Term Sick Leave
Group Money Purchase Plan	Dental Insurance	Signing Bonus	Medical Travel
Prior Service Matched PSPP		Employee Future Benefits	Medical Appointments
Workplace Health Safety and Compensation Premiums			Annual Leave
			Floaters
			Family Leave
			Compassion Leave
			Jury Duty
			Statutory Holiday
			Union Leave
			Banked Overtime

Source: Hydro's 2013 Amended GRA, Exhibit 8, Appendix A.

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