

20th January 2020

David Peters
Principal Lawyer
Via Email: david.peters@kinsmanlegal.com

Dear Mr Peters

Wilson Transformer Company Pty Ltd

I have been engaged by Kinsman Legal on behalf of their client Wilson Transformer Company Pty Ltd to prepare a report with my opinion on the question:

Would prices between relevant related entities (ie importers and exporters) of the following multinational suppliers of power transformers (multinational PT suppliers) be influenced by their commercial, structural or other relationship? Refer to Appendix One – Full Scope of Services

I have read the Expert Evidence Practice Note (GPN-EXPT) and have prepared my report in accordance with this code.

I am the founding director of Transfer Pricing Solutions based in Australia and have consulted to multinational companies on transfer pricing, taxation and accounting for over twenty-five years.

Prior to founding Transfer Pricing Solutions in 2007, I spent 11 years with Ernst & Young offices in Melbourne, Prague, Amsterdam and New York advising some of the world's largest Multinational Companies on their Global transfer pricing. As a boutique transfer pricing practice, we service not only ASX listed, foreign and private companies directly with their transfer pricing matters, but also service many of the 2nd-tier & suburban accounting and law firms to provide transfer pricing services to their clients.

Founded and headquartered in Australia, Transfer Pricing Solutions has expanded over the past four years with offices in Singapore and Malaysia, and continues to be recognized as the leading independent boutique transfer pricing practice in Australia with a strong reputation building in our new locations.

I am passionate about sharing my expertise with others. In 2008 I developed the 'Transfer Pricing – Practice & Problems' subject for Melbourne University's Law School Master of Tax Program and have taught the subject every year since.

In 2016 I was recognised Nationally for my technical expertise when I was appointed to the Australian Governments Board of Taxation Advisory Panel. The panel is recognized as 'Australia's leading taxation professionals', and I am one of only a few non-Big 4/Large Corp to be recognised and appointed to the panel. My position has been renewed each year since.

Over the years I have personally, and Transfer Pricing Solutions, been recognised for our expertise as winners of many awards at the Asia Tax Awards in Singapore, and the Australian Accounting Awards. A key highlight in 2017 was being awarded the Asia Pacific Transfer Pricing Leader of the Year against many well-respected transfer pricing practitioners in Australia and the Asia Pacific Region.

I hold a Masters in International Tax Law, B.Bus Accounting and am a Chartered Accountant, Registered Tax Agent and Authorised Representative Financial Adviser.

With my qualifications and over 25 years transfer pricing experience spread across Australia, Europe, Asia and the US, I am qualified to provide my opinion on the question asked. ***Refer to Appendix Two – Full CV***

Answer to the question presented

Based on my extensive experience working with Multinational companies ("MNC's") on their international related party transactions and pricing, the price between related parties is invariably influenced by the commercial, structural and other relationships within the entities.

In my opinion the prices between the related entities of the multinational suppliers of power transformers listed in appendix one would be influenced by their commercial, structural and other relationships within the entities.

Influence from Policies & Procedures

It is common practice that large MNC's such as those being considered in this report will have in place clear internal policies and procedures guiding management how the organisation should operate. This will include Accounting Manuals which will include an intercompany transactions

policy. This will provide clear instructions to management on how transactions should be conducted and accounted for, the pricing approach for the transactions and often any internal approval process required.

From my experience these policies and procedures are usually prepared by the parent company to ensure consistency throughout the company's Global operations, and to also satisfy the legal and regulatory requirements in the local operations. Once established this will be rolled out throughout the subsidiaries.

I have advised many companies on the international related party transaction section of these manuals or policy documents to ensure they satisfy the transfer pricing requirements. In addition, I have also performed follow up internal audits on some of Australia's largest companies to ensure that management are following the policies.

Influence from the Operational & Legal Structure

It has been my experience that one of the major drivers behind the operational influence will be intellectual property as this will often be the key value driver for the business. The entity with the critical intellectual property, often the parent entity, will have developed products that are either similar to others in the market or superior, and because of their size or global footprint, enabling them to be better than the competition. Structurally the parent company or a special purpose entity, will own the intellectual property, the product will be manufactured in a low-cost country, such as China, with the parent company having a choice of how they want to sell in a local country, such as Australia. This can be direct to end customers, via an intermediary, through a consortium, or most common practice is through its wholly owned subsidiary such as the entities listed in this request.

A local sales entity will be charged with building relationships in the industry to gain potential sales. While the governance of the group may be strategic in setting the overall framework of making and selling (what is sold and how it is sold), operationally related parties cooperate to sell for common gain, and ultimately for the overall gain of the group. So, if the market is competitive and all players are related party groups acting in competition, then each competitive group is cooperating within itself to gain an advantage. The pricing of each competitor to the customer in the marketplace is dictated by how the sale is made - the pricing may be based on a global price list of the goods if are simple / always being made, or a tender if complex and specific to a customer need.

The customer facing related party may well act based on its knowledge of the competitors and price expectation; in which case the related party manufacturer/distributor has to give potentially a discount to gain the sale for both parties overall gain. If the sale is a tender then the manufacture has a much bigger role in design/construction/delivery on time and may dictate the terms the front to customer related party places in the sale documents.

Influence from Related Party 'Group' Dynamics

It is this 'Group' working together that changes the dynamics of pricing, and other commercial arrangements. The OECD and Tax authorities such as the Australian Tax Office have transfer pricing legislation and transfer pricing guidelines as to how profits should be attributed to parties within a group based on the functions, assets and risks to achieve prices that might pertain an arm's length outcome. It is this regulatory requirement from tax authorities which will always require a Group to consider their pricing between Group entities, and thus shows influence because of the related party relationship.

The attribution of profit, or how profit is split between entities is based on reward for functions, assets, and risk which is a formula with a judgment call attached, based on a functional analysis questionnaire and review. It is a weighting and each competitor group may weigh the factors differently, but ultimately may arrive at the same price point to the customer. Whether or not the customer gets the same good/service is based on the facts of the trade under review. Ultimately the customer will choose the product and attached services based on what it considers the selection weighting should be. This final act is what price might pertain in an arm's length transaction so that the related party dealings will always be a single offering with the potential profit split based on how they internally manage their commercial, structural and other factor relationship.

The use of manufacturing in a low-cost country does bring about a further layer of complexity and opportunity as this often results in what the OECD identifies as 'location savings. The Multinational company has an opportunity to consider how the group will financially optimize these savings for the benefit of the overall group. From my experience I have seen Multinational groups passing on part of the 'location savings from the low-cost manufacturing to cost savings to their international customers through lower prices, which increases market share and undercuts other domestic operators in the country of the Groups sales entity. My experience is consistent with recent industry

research on this issue, especially with China being identified as the largest source of competition for the industry.¹ In other situations MNE Groups have also attributed these location savings back to the parent entity. In all instances the relationship between the related entities has influenced the pricing between the entities.

The OECD Transfer Pricing Guidelines discusses location savings² from a transfer “price” perspective, considering how MNE Groups share their location savings between two or more associated enterprises, whether these are retained by a member or members of the MNE Group, or are passed on to independent customers or suppliers. In addition, being part of an MNE Group does provide synergies with members of the Group benefiting from interactions when operating as a group.³ This further supports my statement and practical experience that the price between related parties is influenced by the commercial, structural and other relationships within the entities.

Based on my extensive experience across the Globe working with Multinational companies on their international related party transactions and pricing, I can confidentially say I have never seen a transaction that has not been influenced by the relationships within the entities as the regulatory requirement forces Group entities to consider their relationship.

I conclude, in my opinion the prices between the related entities of the multinational suppliers of power transformers listed in appendix one would be influenced by their commercial, structural and other relationships within the entities.

¹ IBIS World – Industry Report C2439 Power Automation Products and Other Electrical Equipment Manufacturing in Australia – March 2019

² OECD Transfer Pricing Guidelines - Chapter 1: The Arm’s Length Principle Para 1.141 and 1.142

³ OECD Transfer Pricing Guidelines - Chapter 1: The Arm’s Length Principle Para 1.157

Please don't hesitate to contact me on +61 3 5911 7001 if you have any questions or wish to discuss this opinion further.

Yours faithfully



Shannon Smit

Director

Appendix 1 – Scope of Services

Would prices between relevant related entities (ie importers and exporters) of the following multinational suppliers of power transformers (multinational PT suppliers) be influenced by their commercial, structural or other relationship?

Multinational company or group	Related importers	Related Chinese exporters
Siemens Aktiengesellschaft (Siemens AG)	Siemens Australia Pty Ltd (Siemens Australia)	Siemens Transformer (Jinan) Co. Ltd (Siemens Jinan); Siemens Transformer (Wuhan) Co. Ltd (Siemens Wuhan)
General Electric Company	GE Grid Australia Pty Ltd (GE Australia)	GE High Voltage Equipment (Wuhan) Co. Ltd (GE China)
ABB	ABB Australia Pty Ltd (ABB Australia)	ABB Zhongshan Transformer Co. Ltd (ABB Zhongshan); ABB Chongqing Transformer Co. Ltd (ABB Chongqing)
Toshiba conglomerate	Toshiba International Corporation Pty Ltd (TIC)	Changzhou Toshiba Transformer Co. Ltd (CTC)

The question is not concerned with whether prices between related entities of the multinational PT suppliers are or are not at a level that would pertain in an arm's length transaction.

Further information:

Siemens Australia and its Chinese PT suppliers, Siemens Jinan and Siemens Wuhan, have Siemens AG (a publicly listed company in Germany) as a common shareholding company. Siemens Australia is wholly owned, through holding companies, by Siemens AG. Siemens Wuhan is wholly owned by Siemens Ltd., China, which in turn is wholly owned by Siemens AG. Siemens Jinan is a joint venture between Siemens Ltd., China (90 per cent) and XD Jinan Transformer Group Co., Ltd (10 per cent).

TIC and its supplier CTC have a common shareholding company, Toshiba Corporation. Toshiba Corporation has a controlling share in TIC and is a joint venture partner in CTC. Toshiba Corporation is also a technology service provider for TIC.

The ultimate holding company of GE China and GE Australia is General Electric Company which is listed on the New York Stock Exchange.

ABB Australia is 100 per cent owned by ABB (headquartered in Switzerland). ABB Zhongshan is a subsidiary of ABB (China) Ltd; ABB Chongqing is a joint venture established by Chongqing Machinery and Electric Co., Ltd and ABB (China) Limited. ABB (China) Ltd is 100 per cent owned by ABB.

Appendix 2 – CV