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HELLENIC  
UNIVERSITY

Evaluation of an arm's length profitability for a  
company operating in the Greek oil & gas  
industry

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I hereby declare that the work submitted is mine and that where I have made use of another's work, I have attributed the sources according to the Regulations set in the Student's Handbook.

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# Abstract

This dissertation was written as part of the MSc in International Accounting, Auditing and Financial Management at the International Hellenic University.

For at least two decades transfer pricing has become more and more challenging to both multinational enterprises and tax authorities. In case of the multinational enterprises, in planning and implementing their global operations due to the globalized world economy, since they have to comply with laws and administrative requirements that may differ from country to country. In case of tax administrations, specific problems arise at both policy and practical levels.

In the context of this dissertation project is going to be presented how the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations and local Transfer Pricing rules affect the pricing of intragroup transactions. A relevant example from Oil and Gas Industry has been used in order to give a better understanding on how these rules apply.

A company and an industry analysis provide details for the company and the whole environment in which the company operates. Further on, the intragroup transactions are being presented along with a functional analysis in order to identify factors that affect the aforementioned transactions. Afterwards, the relevant legislation is presented and Transfer Pricing methods are outlined. Subsequently, in the economic analysis, the most appropriate transfer pricing method is selected in order to evaluate whether or not the intragroup transactions are within the arm's length range.

Finally, an overall conclusion is drawn on how Transfer Pricing rules can be used to examine the appropriateness of the taxable base of an entity that engages in intragroup transactions through the examination of its profitability with the use of the applicable methods.

All data used, was from Amadeus database as well as from the financial statements of LPC S.A. Additional information was obtained from the OECD Guidelines for Multinational Enterprises and Tax Administrations. Moreover, information from the international and domestic press and scientific websites.

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# 1 Introduction

## 1.1 Objectives

The report has been prepared in line with the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017) (“OECD Guidelines”), the provisions set out in articles 50 and 51 of Greek Income Tax Code ( GITC 4172/2013) and the article 21 of Law 4174/2013, according to Greek Transfer Pricing Legislation.

The purpose of this report is to identify the documentation method that is considered to be the most reliable to verify the compliance with the arm’s length principle with respect to the company’s transactions with affiliated parties. In addition, the information and analysis required to support the above conclusion are provided. Finally, based in the chosen method, a conclusion is reached on the observance of the arm’s length principle for the intragroup transactions under consideration.

## 1.2 Executive summary

LPC S.A. is a manufacturing company that produces base lubricants and other lubricant products.

In the context of this report the pricing of the transactions that the company realized with affiliated parties during the fiscal year 2016 were examined. Those transactions included sales of lubricants, services and other as well as, purchases from related parties. The method that was used in order to evaluate the pricing of those transactions was the Transactional Net Margin Method (TNMM).

### *Summary of results*

During the fiscal year under scrutiny LPC S.A. realized income from sales of products, services and other and made purchases from related parties. All the above transactions were closely linked with the operation of the company and therefore were examined in aggregate as far as their pricing was concerned.

In the context of the application of the TNMM, the company's Return On Total Costs (ROTC) was calculated for 2016 and was equal to 6.18%. The aforementioned result was found to be within the interquartile range of the Weighted Average ROTC realized by comparable independent companies during the three year period 2013-2015 (3.40% to 8.32% with a median of 5.41%), as identified by the relevant benchmarking study.

Thus, it can be concluded that the application of the TNMM has provided adequate evidence that the pricing of the transactions under examination was in line with the arm's length principle.



## 2 Company Analysis

### 2.1 Introduction

LPC S.A. operates simultaneously at industrial production of basic lubricants, at production and selling of prepackaged lubricant products as well as at selling paraffin and other products of oil. LPC's major aim is to give her clients high quality products in order to satisfy their needs and at the same time show respect to community and environment.

#### 2.1.1 Historical background

The company was founded in 1981.

In 1982, the refinery production plant for basic lubricants was launched. It was created using the most modern standards of construction and the technical know-how of the top experts under the guidance of the Italian company TECHNIPETROL.

In 1986, LPC S.A. launched its blending plant. This gave the opportunity to the company to produce final lubricants. Moreover, in the same year the company expanded its operations in selling paraffin.

In 1988, the company, for the first time in Greek market, developed and started selling self-made lubricants under the brand name "CYCLON". LPC S.A. organized a pan-Hellenic sales network.

Three years later, in 1991, the company started to export its products.

In 1993, a new production plant was launched that gave the capability to produce a different type of lubricants (Bright Stock). LPC S.A. became the only company in Greece that could produce this specific fraction of basic mineral oil.

In 1994, the company reconstructed its production lines something that helped to grow its capacity of production from 25,000 to 40,000 tons per year.

Five years later, in 1999, LPC S.A. started to operate in the fuel market and created a network of service stations named "CYCLON".

In 2001, the company changed its brand name in “CYCLON Hellas S.A.” and started to trade its shares in the Athens Stock Exchange.

From 2002 until 2013, the company proceeded to various buyouts and establishments of companies in Bulgaria, Romania, Libya and Serbia.

Finally, in 2015 “CYCLON Hellas S.A.” was split in two separate fields (fuels and lubricants). Fuels field was absorbed by “AVINOIL S.A.” whilst lubricants contributed to the newly established LPC S.A.

### 2.1.2 LPC S.A. in 2016

The main business segment of the company is the production and selling of base lubricants and finished (packaged) lubricants.

In the last three years the exports of the company, as far as the field of lubricants is concerned, faced an upward trend. This is something that is expected to continue in the upcoming years certifying company’s exporting orientation.

Furthermore, fiscal year 2016 is characterized by a consecutive reduction of the company’s expenses (approximately 0.1%) compared to the year before which was also decreased by 5% compared to 2014.

The annual turnover amounted to €66,728,000 and EBITDA equaled €4,922,000. The company during 2016 increased its sales in lubricants by 19.5%.

- Sales in lubricants total 65,582 MT
- Sales in natural gas total 297MW

The gross profit ratio reached 16%.

During 2016 the company made investments for tangible and intangible assets that amounted to €895,000. More specifically, for the production process (refinery) were invested €834,000 and other investments amounted €61,000.

However, due to the economic recession an extremely unstable setting exists and makes the company believe that sales will be affected unfavorably in the forthcoming period and until the country spring back to a more stable economy. Considering those facts, the company preserves its main strategy to rise and expand sales network emphasizing

in sales abroad. In addition, implements techniques in order to secure sales, credits and liquidity, endorse its clientele and minimize as much as possible credit risk.

## 2.2 Organization

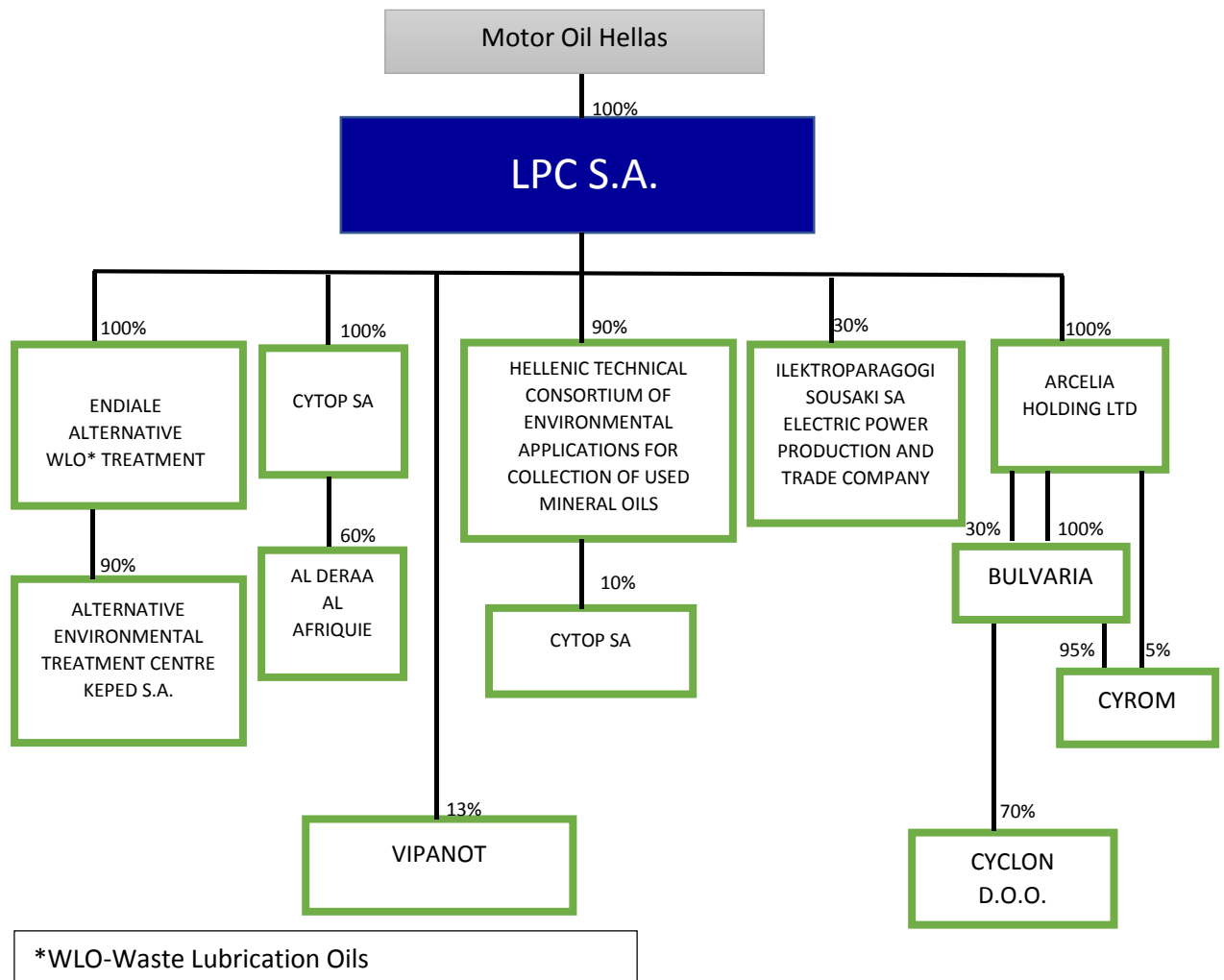


Figure 1 Organizational structure of LPC S.A.

## 2.3 Business strategy

- Grow the export operations in lubricants field.
- Intensify collecting waste oils in internal market.
- Develop new collaborations based on new sources of raw materials (waste oils) and expand in Mediterranean and Balkan states.
- Reduce the days of credit to customers in order to reduce the credit risk.

- Elaborate activities for “AVIN” lubricants which are managed by LPC S.A.
- Discover new synergies with the Group’s companies aiming at a further reduction of costs.
- Upgrade rendering of services for lubricant customers.
- Upgrowth a new delegation of “Valvoline”.

## 2.4 Business activities

LPC S.A. owns a contemporary refinery for the production of mineral oil products in Aspropyrgos, Attica where they manufacture a wide range of lubricants which can cover the market’s needs. Meantime, those facilities are the only that produce the heavy mineral oil called “Bright stock” in Greece.

The refinery’s facilities can be divided into the following segments:

- Production of basic lubricants

The technologically advanced production process of the refinery has as a result the production of base mineral oils with a very high quality that can cover the modern and the most challenging standards in their class.

- Finishing of lubricant products- Storage/Logistics

The company produces and packages almost 50,000 metric tons ready to use lubricants. In its production facilities about 200 different types of lubricants are being produced so as to cover the needs of every type of machinery and vehicle for lubrication. This segment manages blending and packaging.

After packaging final products are being transported and stored at warehouses until being placed in the market.

- Biological cleaning and treatment unit

Company’s ultimate goal is to minimize the use of natural resources and to recycle as much as possible processed liquid wastes. LPC S.A. invests in the implementation of new technologies for the process of liquid wastes and in this context and philosophy the biological cleaning unit operates very successful at their premises, at Aspropyrgos’ refinery.

- Product development and quality assurance unit

In alliance with the proficient departments of the company, new products are being developed which cover the highest standards in a continuously evolved lubricant market whilst during the phases of production, packaging and storing are being under review in order to secure the quality of products. The Safety, Health and Quality department in conjunction with the Chemical unit which is highly apparatus and certified, are responsible for the quality maintenance of all the produced and traded products of the company.

## 2.5 Products and Customers

PLC offers to its clientele both final products and services.

Considering as main goal the quality excellence, the company provides lubricant products for commercial customers, industries, shipping and for special uses. Studying carefully the requirements from the application of lubricants and also the peculiar needs of final users of those products, they put emphasis on the advocacy of solutions based on technological novelty, maintain stable caliber, cost less for the end-consumer while do not burden the environment.

LPC supplies the market with the following types of commodities:

- Basic lubricants, vehicle lubricants, industrial lubricants, marine lubricants, greases
- Special products
- Paraffin

Observing customers' necessities and also the international trends and developments, LPC tries to find alternatives so as to provide them with better services as a return for their affinity to company's products. In that way, the company has developed a set of services, through web services, that give customer the opportunity to handle and monitor the condition of the lubricant in use and the lubricated machinery/engine.

## 2.6 Competition

### *Greek lubricant market*

Automotive lubricants needs, is affected both by the development and compound of the fleet of in-service vehicles as well as by technological advances in both engine and lubrication. The growth of industrial production and marine activity define to a considerable extent the need for marine and industrial lubricants.

The market of vehicle and industrial lubricants follows a downward trend during the last 8 years. The same applies for the market of marine lubricants.

The total domestic automotive lubricants' market faces a downward trend in recent years while the consumption was estimated about 34 million litres in 2014. For 2015 it was observed a further decline of about 4%. Based on sectorial studies this trend in consumption is expected to be followed until 2018 but at a lower rate of decline.

The continuous downturn of domestic lubricant usage rate is due to numerous factors. New technology engines lead to less often changes in lubricants in comparison with the older ones. The advancement of lubricants' synthesis also contribute to the reduction of lubricants' consumption. Moreover, due to the economic recession the use of vehicles has been decreased resulting in extended intervals of the lubricant change.

The domestic consumption in industrial lubricants in 2014 was about 15.5 million litres with a further reduction of about 10% in 2015 while for 2016 it was projected that this percentage would remain stable. The main reason for this dent was the cut down of the industrial production due to the recession.

The total market for marine lubricants has been lessened by 6.3% in 2014 compared to 2013 reaching 27,000 tons where it was stabilized for the years 2015 and 2016.

National exports in lubricant's field was significantly important in 2015. That led the sector in the first rank of national exports. Most of the exported lubricants in 2014 were absorbed by the Eastern Mediterranean countries. LPC S.A. producing Cyclon lubricants was the top company in exports with more than the 78% of the national exported lubricants.

# 3 Industry analysis

## 3.1 Introduction

For the purposes of analyzing the pricing of the intragroup transactions realized between LPC S.A. and the rest entities of the group, it is important in first place to gain the necessary knowledge and understanding about the specific industry/market in which LPC S.A. operates, including the structure of the market, services, competition, market trends, value drivers as well as industry risks that impact the profitability of the company and, therefore, also its transfer pricing. Accordingly, the industry analysis is essential for the determination and documentation of arm's length transfer prices.

The preparation of an industry analysis is recommended by the OECD Transfer Pricing Guidelines (Ch. 3 par. 7) as a document useful in determining transfer prices between related parties. Further, it is required by most jurisdictions having incorporated transfer pricing documentation requirements in their local tax law or transfer pricing regulations.

## 3.2 Industry overview

### 3.2.1 Global market

The brisk development of industrial power and developing demand has raised the production rate in all manufacturing companies, all over the world. This, led industries to be more worried with the maintenance of machinery to provide better quality product. This has driven the need of lubricants forward to higher level.

In 2013, China's market accounted for more than 56% of the total Asia-Pacific market and was considered as the largest lubricants market. During the last few years it surpassed the leading lubricants market – the United States – and is anticipated to continue to prevail the market of lubricants. Additionally, North America's market is at its peak and from now on is anticipated to register stagnant growth.

The ongoing trend in the lubricants market, bio-based lubricants, aim to lessen the devastating effects in the environment. At the same time, this trend assists the total growth of the market. Synthetic lubricants have substituted ordinary lubricants as a

result of the increased need for enriched fuel efficiency. This tendency influences in a great extent the whole market.

The heavy demand for lubricants is due to the development in the automotive industry and the industrial production. Over 50% of the total lubricants market, in terms of volume, belongs to the transportation segment.

Severe vehicle emission regulations and the increased performance features of the new types of lubricants resulted in an alteration from conventional lubricants to synthetic and bio-based lubricants. Specifically, the rate of swapping in transportations from the former to the latter is very rapid.

The biggest end use for lubricants is still the motor vehicle aftermarket; however, a shift in growth to other big lubricant's markets is expected since the periods between lubricants' change is extended and the purchases of electric vehicles are increased especially in developed nations. Demand in the manufacturing market will post faster gains as manufacturing output elaborates, especially in developing regions. Additionally, it is expected that the increased demand for efficient lubricants by manufacturers will lead in a quality improvement. Demand in the rest industries, is expected to rise at an above-average rate. Factors, such as increased mechanization in agriculture and other segments, the intensified production of oil and gas and the regular use of marine and railroad transportations, contribute in the augmentation of this growth.

Shell, Lukoil, Exxon Mobil, BP, Total and others are considered as leading companies in lubricants' industry.

### 3.2.2 Greek market

According to a study of IOBE<sup>1</sup>, oil trading sector as a whole seemed to recover most of the lost profit margins, of the first period of the crisis, in 2015. This trend in 2016 reached a top point when gross profitability of the companies in the sector increased by 14.7% as the gross profit margin stood at 5.2%, compared with 4.5% in 2015 and 3.2% in 2012 when it was its lowest levels. Net profit for the industry was reduced at 7.3 million euro

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<sup>1</sup> Foundation for Economic & Industrial Research-[Financial Data of Oil and Oil Products for 2016](#)



from 16.8 million euro at 2015, a result which was significantly affected by the payment of income taxes of 15.8 million euro.

## 4 Overview of intragroup transactions

### 4.1 Introduction

The tables below present the transactions that LPC S.A. have realized with related parties during 2016 and for which a documentation requirement exists under Greek TP legislation.

<i>Counterparty</i>	<i>Nature of transaction</i>	<i>Value of transaction (Euro)</i>
ENDIALE S.A.		2,000
KEPED S.A.		-
HELLENIC TECHNICAL CONSORTIUM OF ENVIRONMENTAL APPLICATIONS FOR COLLECTION OF USED MINERAL OILS		6,000
CYTOP		238,000
BULVARIA		1,217,000
CYROM		1,601,000
CYCLON LUBRICANTS DOO BEOGRAD		1,089,000
ADAA JV		22,000
MOTOR OIL S.A.		9,760,000
	SALES, SERVICES & OTHER INCOME	
AVIN OIL S.A.		2,184,000
CORAL S.A.		11,000
CORAL GAS S.A.		-
MOTOR OIL TRADING S.A.		1,479,000
B.F.S. S.A.		-
MAKRAION S.A.		-
SEKAVIN S.A.		13,000
AIR LIFT		38,000
M&M GAS		-
ALL SPORT S.A.		35,000

Table 1 Income from related parties for the FY 2016

<i>Counterparty</i>	<i>Nature of transaction</i>	<i>Value of transaction (Euro)</i>
ENDIALE S.A.		370,000
KEPED S.A.		36,000

HELLENIC TECHNICAL CONSORTIUM OF ENVIRONMENTAL APPLICATIONS FOR COLLECTION OF USED MINERAL OILS		17,000
CYTOP		3,746,000
BULVARIA		208,000
CYROM		-
CYCLON LUBRICANTS DOO BEOGRAD		18,000
ADAA JV		296,000
MOTOR OIL S.A.		15,514,000
AVIN OIL S.A.	PURCHASES	132,000
CORAL S.A.		50,000
CORAL GAS S.A.		65,000
MOTOR OIL TRADING S.A.		-
B.F.S. S.A.		1,000
MAKRAION S.A.		6,000
SEKAVIN S.A.		-
AIR LIFT		-
M&M GAS		1,087,000
ALL SPORT S.A.		35,000

*Table 2 Purchases from related parties for the FY 2016*

## 4.2 Presentation of intercompany transactions

### 4.2.1 Transactions realized within the context of lubricants production

As already stated before, the main business activity of the company is the manufacturing and selling of base and prepackaged lubricants. The transactions between LPC S.A. and the affiliated companies are mostly from sales and purchases of products and services.

More specifically, income from sales has to do with sales of final products, rents and storage services. Purchases pertain to purchases of raw materials and recycling fees.

## 5 Functional analysis

One of the preliminary steps of a transfer pricing analysis is to obtain a detailed understanding of the functions performed, risks assumed, and assets used by each of the entities engaged in the intercompany transactions under examination. Such fact-finding is necessary to properly characterize the roles of the related parties involved in covered transactions and to determine comparability between controlled and uncontrolled transactions.

In particular, a functional analysis attempts to identify the value added functions performed by the participants in controlled transactions. The identification of the relevant value added activities also includes specific risks associated with these transactions. The risks may relate directly to the specifics of the transaction or the general business risk.

### 5.1 Functions performed - Lubricants activity

LPC S.A. is responsible for all the functions relating to its production activity including:

- Procurement of raw materials from domestic and foreign vendors,
- Research and Development,
- Production of lubricants,
- Packaging of final lubricants,
- Sales & Marketing.

### 5.2 Risks assumed

Generally, the return of an investment should be relevant to the undertaken by the company risks so as to accomplish this investment. Based on this, it could be reasonable to assume that greater risks would yield in greater profits.

Hence, the comparability amongst controlled and uncontrolled transactions is influenced in a great extent from the type of risks assumed in the context of the transactions under review as well as the extent those risks are undertaken.

Therefore, the analysis of the risks assumed is necessary so as to draw a conclusion whether or not these transactions are at arm's length.

#### *Market risk*

Market risk is closely linked with the demand for company's products and especially with sales' volume and price. This risk is even more important taking into account the economic recession.

#### *Foreign exchange risk*

This risk relates to the potential impact on profits that may rise because of changes in foreign exchange rates.

LPC S.A. operates mostly in the domestic market (62% sales in the domestic market and 38% exports). Any fluctuations in exchange rates affect the company in the case of transactions made in a different currency (other than Euro). Transactions in other currency than euro are expressed mostly in US dollar. The exposure in this risk is minimized by the company, with the physical hedging policy, by counterbalance assets and liabilities in the foreign currency. Therefore, this risk is not considered crucial and there is not any specific policy adopted by the company.

#### *Interest rate risk*

The company is subject to this risk due to the long term borrowings with fluctuating interest rate euribor and spread which even in the case of being unable to reach its financial indicators of the long term borrowing, will not exceed the commensurable of the short term borrowing.

This risk is not considered crucial by the company and thus there is not any further policy applied to manage it.

#### *Credit risk*

Credit risk refers to the potential inability to collect the receivables that are a result of the daily transactions of the company. LPC's exposure to credit risk is limited due to the fact that it maintains a large client base and does not depend on specific large customers.

The company in order to further minimize this risk has adopted additional policies:

- Evaluates and selects the most reliable customers,
- Contracts new collaborations with advanced payment terms,
- Requests some form of guarantee against pricing,
- Ensures reliable sources of information concerning the financial performance of the customers,
- Confines sales to customer categories whose industries are considered to be of high credit risk,
- Reduces credit days to customers resulting in a reduction in the credit exposure and risk.

#### *Liquidity risk*

Liquidity risk is the risk that arise when the expiring date of the assets and liabilities is not coincide. When this happens, the collectivity may rise but at the same time losses could rise. LPC S.A. implement procedures in order to minimize such losses. The company retains sufficient cash and other high liquidity assets and maintains an adequate amount of secured credit facilities.

LPC S.A. achieves effective liquidity risk management primarily through the creditworthiness and lending capacity equation and secondarily, by retaining sufficient cash as well as securing the possibility of direct bank financing in the event of an unforeseen need. Continuous budget monitoring and immediate response to forecasting and facts also achieves timely balancing cash inflows and outflows.

### 5.3 Assets used

The company uses significant fixed assets in order to carry out its activities such as land, buildings, furniture, machinery and transportation equipment, warehouses, biological equipment and the refinery at Aspropyrgos.

LPC S.A. possesses a modern refinery for the production of lubricant products at Aspropyrgos Attica with annual capacity of 40,000 tons mineral oil where a wide range of base lubricants are produced. Furthermore, the company owns its own Blending and

Packaging of final lubricant products with annual production capacity of 16,000 metric tons per shift (8 hours/shift).

Company's tangible assets in 31<sup>st</sup> December 2014, in the context of the dissolution in the segments of fuels and lubricants, assessed by an independent third party (chartered assessor). Subsequent acquisitions are measured at cost less accumulated depreciation and any impairment loss. Acquisition cost also includes all costs directly related to the acquisition of assets.

Subsequent costs are added to the carrying amount of tangible fixed assets or are recognised as a separate asset only if it is expected to generate future economic benefits to the company and their cost can be measured reliably. Repairs and maintenance costs are recognised in the income statement.

For the fiscal year under scrutiny, the net book value of tangible fixed assets of the company amounted to €16,811,000.

# 6 Transfer pricing analysis

## 6.1 Overview of Greek Transfer Pricing Legislation

On 1<sup>st</sup> of January 2014 a new tax bill was approved by the Greek Parliament for the Code of Income Taxation (l. 4172/2013) which brought numerous changes to the tax rules affecting individuals and companies.

Furthermore, a ministerial decision has been issued by the Greek Ministry of Finance providing guidance on the contents of the transfer pricing documentation file, the parties subject to the transfer pricing rules and exemptions thereby, language requirements, transfer pricing documentation methods and the content of the Summary Information Table (SIT). The ministerial decision POL 1097 provides guidance and clarifications on Greek transfer pricing rules and documentation requirements under the new tax regime.

### *Deadline for the submission of the Summary Information Table (SIT)*

According to the ministerial decision until 2016 the deadline for the submission of the SIT was the end of the fourth month following the taxpayer's fiscal year end. After the amendment to the Code of Tax Procedures (l. 4174/2013) by law 4410/2016 the deadline for the submission of the SIT and the Greek transfer pricing file deferred to the deadline for submission of the annual income tax return that is six month after the taxpayers fiscal year end.

The summary of the information has to be filled and submitted electronically on the web page of the General Secretariat of Information Systems (GSIS) – [www.gsis.gr](http://www.gsis.gr) – of the Greek Ministry of Finance whilst it should not be considered in any way complete and sufficient transfer pricing documentation that gives evidence for the compliance of the taxpayer's intragroup transactions with the arm's length principle.

### *Companies and transactions subject to documentation requirements*

When determining the companies which are liable for the documentation of the transfer pricing file and the submission of the summary information table, the scope of article 2



of the Income Tax Code is examined, where the definition for related parties is provided. It is about domestic legal entities (Greek Société Anonymes, limited liability companies, cooperatives, associations, foundations, consortia, etc.) that are subject to transfer pricing documentation requirements.

More specifically, the relation between the different parties comes up due to direct or indirect participation in management, control or capital. Especially, it is tested if the percentage of the participation exceeds 33% or if any third person owns this percentage in two or more people.

Thereinafter, the exemption limits are taken under consideration where the annual turnover combined with the aggregate tested intra-group are examined.

Exemptions from the transfer pricing documentation obligation apply in the following cases:

- Intragroup transactions or transfers of functions with one or more related parties not exceeding €100,000 annually and in total, provided the taxpayer's turnover during the fiscal year does not exceed €5,000,000.
- Intragroup transactions or transfers of functions with one or more related parties not exceeding €200,000 annually and in total, provided the taxpayer's turnover during the fiscal year exceeds €5,000,000.
- Commercial/industrial special purpose companies established under the provisions of Law 89/1967 are exempt from the transfer pricing documentation obligation because these companies already document their intercompany transactions through the preapproval of their cost plus method.

If the intercompany transactions or transfers of functions, in total and not per category of transaction or per company, exceed the €100,000 and €200,000 thresholds annually, then the documentation requirement is triggered for every separate intragroup transaction or transfer of function, irrespective of its value.

### *Transfer Pricing Documentation File*

Based on the amendment in Law 4174/2013 (Code of Tax Procedures) by the Law 4410/2016 the transfer pricing documentation file must be prepared by the taxpayers until their annual income tax return.

The transfer pricing documentation file must be kept in company's registered office for as long as the company is obliged to keep the records of the relevant tax year. Additionally, if tax authorities request to audit the file it must be made available within 30 days following the request.

### *Penalties and Fines for Incomplete or Inadequate Documentation*

After Law 4337/2015 was enacted several amendments on the Code of Tax Procedures were introduced. As far as Transfer Pricing is concerned penalties and fines were altered. More specifically:

#### *Late submission of SIT*

Delinquent submission of the initial SIT a one-off penalty is imposed equal to 0.1% of the amount of intragroup transactions. This fine is not possible to be under €500 or over €2,000.

#### *Amending SIT*

Same amounts as above apply under the prerequisite that the modification cause changes in total amount of intragroup transactions more than €200,000.

#### *No submission of the SIT*

In this case the fine equals with 0.1% of intragroup transactions and with a minimum allowance €2,500 and a maximum of €10,000.

#### *Submission of an inaccurate/incomplete SIT*

The penalty compelled, when a SIT is incomplete or inadequate, is calculated in the same way as for the fine for delayed submission of the SIT beside that the 0.1% is calculated on the amount that it is inaccurate and only if this inaccuracy exceeds 10% of total transactions. The minimum amount of the fine is €500 and the maximum is €2,500.

### *Late submission of the Transfer Pricing documentation file to the Tax Administration*

After the application of the new law plan late submission or the non-submission of the Transfer Pricing documentation file is categorized based on the overdue days affecting the amount of the fine. The main criterion for this categorization is the time interval upon the expiration of the 30 days deadline. More specifically:

If the documentation file is made available to Tax Authorities until the 30<sup>th</sup> day from the receipt of request no fine is imposed.

If the documentation file is delivered between the 31<sup>st</sup> and 60<sup>th</sup> day there is a fine of €5,000.

If the documentation file is delivered between the 61<sup>st</sup> and the 90<sup>th</sup> day there is a fine of €10,000.

If the documentation file is delivered after the 90<sup>th</sup> day or not at all there is a fine of €20,000.

In the table below fines and penalties are summarized:

<i>Case</i>	<i>Fine</i>
<b>Late submission of SIT</b>	0.1% of the transactions to be documented. Minimum fine 500€ and maximum 2,000€
<b>Amending SIT</b>	Only where the amendment concerns total charges to the value of the transactions to be documented over 200,000€. 0.1% of the transactions to be documented. Minimum fine 500€ and maximum 2,000€
<b>No submission of the SIT</b>	0.1% of the transaction to be documented. Minimum fine 2,500€ and maximum 10,000€
<b>Submission of an inaccurate/incomplete SIT</b>	Only where the inaccuracy concerns more than 10% of the total transactions to be documented. 0.1% of the amounts involved in the inaccuracy. Minimum fine 500€ and maximum 2,000€
<b>Late submission of the TP documentation file to the Tax Administration</b>	Submission between the 31 <sup>st</sup> and the 60 <sup>th</sup> day from the notification of the relevant request. Fine 5,000€

	Submission between the 61 <sup>st</sup> and the 90 <sup>th</sup> day from the notification of the relevant request. Fine 10,000€ Submission after the 90 <sup>th</sup> day from the notification of the relevant request or no submission. Fine 20,000€
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*Table 3 Fines and penalties*

## 6.2 The arm's length principle

The arm's length principle "is the international transfer pricing standard that OECD Member countries have agreed should be used for tax purposes by MNE groups and tax administrations". (§1.1 OECD Guidelines) An arm's length price is generally considered to be the price that would exist if the related parties to the transaction were dealing with each other as independent parties. "The authoritative statement of the arm's length principle is set forth in Article 9, Paragraph 1 of the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD Member countries and an increasing number of non-member countries. Article 9 provides": (§ 1.6 OECD Guidelines)

"[Where] conditions are made or imposed between [...] two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly."

The arm's length principle has been embraced not only by the OECD Member countries but also from other countries in order to assess transfer prices between related or controlled enterprises as an expedient of securing the appropriate tax base in each jurisdiction and avoiding double taxation. "[The arm's length principle] provides the closest approximation of the workings of the open market in cases where property (such as goods, other types of tangible assets, or intangible assets) is transferred or services are rendered between associated enterprises. [...] This reflects the economic realities of the controlled taxpayer's particular facts and circumstances and adopts as a benchmark the normal operation of the market." (§ 1.14 OECD Guidelines)

## 6.3 Determining comparability

“[...] Application of the arm’s length principle is based on a comparison of the conditions in a controlled transaction with the conditions that would have been made had the parties been independent and undertaking a comparable transaction under comparable circumstances.” (§ 1.33 OECD Guidelines) Sufficient comparability must exist in the economic characteristics of the compared situation so as for the comparison be relevant from an economic perspective.

“The typical process of identifying the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations requires a broad-based understanding of the industry sector in which the Multinational Enterprise (MNE) group operates [...] and of the factors affecting the performance of any business operating in that sector.” (§ 1.34 OECD Guidelines)

“The accurate delineation of the actual transaction or transactions between the associated enterprises requires analysis of the economically relevant characteristics of the transaction. These economically characteristics consist of the conditions of the transaction and the economically relevant circumstances in which the transaction takes place. The application of the arm’s length principle depends on determining the conditions that independent parties would have agreed in comparable transactions in comparable circumstances. [...], it is therefore vital to identify the economically relevant characteristics of the commercial or financial relations as expressed in the controlled transaction.” (§1.35 OECD Guidelines)

Attributes or “comparability factors” include, but are not limited to, the characteristics of the property or services transferred, the functions performed by the parties (taking into account assets used and risks assumed), contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties.

## 6.4 Evaluation of separate and combined transactions

“Ideally, in order to arrive to the most precise approximation of arm’s length conditions, the arm’s length principle should be applied on a transaction-by-transaction basis. However, there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis. Examples may include: a) some long-term contracts for the supply of commodities or services, b) rights to use intangible property, and c) pricing a range of closely-linked products (e.g. in a product line) when it is impractical to determine pricing for each individual product or transaction.” (§ 3.9 OECD Guidelines)

## 6.5 Arm’s length range

In the Guidelines is stated that: “In some cases it will be possible to apply the arm’s length principle to arrive at a single figure (e.g. price or margin) that is the most reliable to establish whether the conditions of a transaction are arm’s length.” The OECD Guidelines recognise, however, that “there will also be many occasions when the application of the most appropriate method or methods produces a range of figures all of which are relatively equally reliable.” (§ 3.55 OECD Guidelines) “Where the application of the most appropriate method [...] produces a range of figures, substantial deviation among points in that range may indicate that the data used in establishing some of the points may not be as reliable as the data used to establish the other points in the range or that the deviation may result from features of the comparable data that require adjustments. In such cases, further analysis of those points may then be necessary to evaluate their suitability for inclusion in the arm’s length range.” (§ 3.59 OECD Guidelines)

“In order to obtain a complete understanding of the facts and circumstances surrounding the controlled transaction, it generally might be useful to examine data both from the year under examination and prior years. [...] For example, the use of data from past years will show whether a taxpayer’s reported loss on a transaction is part of a history of losses on similar transactions, the result of particular economic conditions in a prior year that increased costs in the subsequent year, or a reflection of the fact that a product may be at the end of its life cycle. [...] Multiple year data will also be useful in

providing information about the relevant business and product life cycles of the comparables.” (§ 3.76, 3.77 OECD Guidelines)

## 6.6 Transfer Pricing Methods

There are 3 traditional transaction methods described by the OECD Guidelines for the application of the arm’s length principle:

- Comparable uncontrolled price (CUP) method,
- Resale price method (RPM), and
- Cost plus method.

In addition, there are 2 other non-traditional methods, specifically transactional profit methods, are addressed by the OECD Guidelines.

### 6.6.1 Traditional transaction methods

“The selection of a transfer pricing method always aims at finding the most appropriate method for a particular case.” (§ 2.2 OECD Guidelines) “Traditional transaction methods are regarded as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are arm’s length.” (§ 2.3 OECD Guidelines)

#### *Comparable uncontrolled price method*

“The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.[...]Where it is possible to locate comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arm’s length principle. Consequently, in such cases the CUP method is preferable over all other methods.” (§ 2.14, 2.15 OECD Guidelines)

“It may be difficult to find a transaction between independent enterprises that is similar enough to a controlled transaction such that no differences have a material effect on

price. For example, a minor difference in the property transferred in the controlled and uncontrolled transactions could materially affect the price even though the nature of the business activities undertaken may be sufficiently similar to generate the same overall profit margin.” (§ 2.16 OECD Guidelines) “[...], regard should be had to the effect on price of broader business functions other than just product comparability (i.e. [Other comparability factors include functions performed, risks assumed, and contractual terms]). Where differences exist between the controlled and uncontrolled transactions or between the enterprises undertaking those transactions, it may be difficult to determine reasonably accurate adjustments to eliminate the effect in price. [...] Every effort should be made to adjust the data so that it may be used appropriately in a CUP method.” (§ 2.17 OECD Guidelines)

#### *Resale price method*

“The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price [...] is then reduced by an appropriate gross margin on this price representing the amount of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product (e.g. custom duties), as an arm’s length price for the original transfer of property between the associated enterprises. This method is probably most useful where it is applied to marketing operations. The resale price margin of the reseller in the controlled transaction may be determined by reference to the resale price margin that the same reseller earns on items purchased and sold in comparable uncontrolled transactions (“internal comparable”). Also, the resale price margin earned by an independent enterprise in comparable uncontrolled transactions may serve as a guide (“external comparable”).” (§ 2.27, 2.28 OECD Guidelines) “In making comparisons for purposes of the resale price method, fewer adjustments are normally needed to account for product differences than under the CUP method, because minor product differences are less likely to have as material an effect on profit margins as they do on price.” (§ 2.29 OECD Guidelines)



### *Cost plus method*

“The cost plus method begins with costs incurred by the supplier of property (or services) in a controlled transaction for property transferred or services provided to an associate purchaser. An appropriate cost plus mark-up is then added to this cost, to make an appropriate profit in light of the functions performed and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm’s length price of the original controlled transaction. This method probably is the most useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or where the controlled transaction is the provision of services.” (§ 2.45 OECD Guidelines) “The cost plus mark-up of the supplier in the controlled transaction should ideally be established by reference to the cost plus mark-up that the same supplier earns in comparable uncontrolled transactions (“internal comparable”). [...] The cost plus mark-up earned in comparable transactions by an independent enterprise may serve as a guide (“external comparable”).” (§ 2.46 OECD Guidelines)

When applying the cost plus method, “it is particularly important to consider differences in the level and types of expenses-operating expenses and non-operating expenses including financing expenditures – associated with functions performed and risks assumed by the parties or transactions being compared” (§2.51 OECD Guidelines) “As under the resale price method, where there are differences that materially affect the cost plus mark-ups earned in the controlled and uncontrolled transactions (for example in the nature of the functions performed by the parties to the transactions), reasonably accurate adjustments should be made to account for such differences. The extent and reliability of those adjustments will affect the relative reliability of the analysis under the cost plus method in particular cases.” (§ 2.47 OECD Guidelines)

### **6.6.2 Transactional profit methods**

“The transactional profit methods [...] are the transactional profit split method and the transactional net margin method. Profits arising from a controlled transaction can be a

relevant indicator of whether the transaction was affected by conditions that differ from those that would have been made by independent enterprises in otherwise comparable circumstances.” (§2.63 OECD Guidelines)

*Transactional net margin method (TNMM)*

“The transactional net margin method examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction [...]. Thus, a transactional net margin method operates in a manner similar to the cost plus and resale price methods. This similarity means that in order to be applied reliably, the transactional net margin method must be applied in a manner consistent with the manner in which the resale price or cost plus method is applied. [...] The net profit indicator of the taxpayer from the controlled transaction [...] should ideally be established by reference to the net profit indicator that the same taxpayer earns in comparable uncontrolled transactions [...]. Where this is not possible, the net margin that would have been earned in comparable transactions by an independent enterprise may serve as a guide.” (§ 2.64 OECD Guidelines)

“In applying the transactional net margin method, the selection of the most appropriate net profit indicator should follow the guidance in relation [...] to the selection of the most appropriate method to the circumstances of the case. It should take into account of the respective strengths and weaknesses of the various possible indicators; the appropriateness of the indicator considered in view of the nature of the controlled transaction, determined in particular through a functional analysis; the availability of reliable information (in particular on uncontrolled comparables) needed to apply the transactional net margin method based on that indicator; and the degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments that may be needed to eliminate differences between them, when applying the transactional net margin method based on that indicator.” (§ 2.82 OECD Guidelines)

“Net profit indicators may be directly affected by [...] forces operating in the industry as follows: threat of new entrants, competitive position, management efficiency and individual strategies, threat of substitute products, varying cost structures [...],

differences in the cost of capital [...], and the degree of business experience [...].” (§ 2.77 OECD Guidelines)

In determining the net profit, “only those items that (a) directly or indirectly relate to the controlled transaction at hand, and (b) are of an operating nature, should be taken into account in the determination of the net profit indicator for the application of the transactional net margin method.” (§ 2.83 OECD Guidelines)

Factors such as multiple year of data and the use of non-transactional third party data as well as arm’s length range and the tested party should be investigated too.

#### *Transactional profit split method*

“The transactional profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction [...] by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions. The transactional profit split method first identifies the profits to be split for the associated enterprises from the controlled transactions in which the associated enterprises are engaged (the ‘combined profits’). References to ‘profits’ should be taken as applying equally to losses. It then splits those combined profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm’s length.” (§ 2.114 OECD Guidelines) “The relevance of comparable uncontrolled transactions or internal data and the criteria used to achieve an arm’s length division of the profits depend on the facts and circumstances of the case.” (§ 2.138 OECD Guidelines)

“There are a number of approaches for estimating the division of profits, based on either projected or actual profits, as may be appropriate, to which independent enterprises would have agreed [...]”(§2.124 OECD Guidelines) The OECD Guidelines discuss two of those. “These approaches – contribution analysis and residual analysis – are not necessarily exhaustive or mutually exclusive.” (§2.124 OECD Guidelines) “Under a contribution analysis, the combined profits, which are the total profits from the controlled transactions under examination, would be divided between the associated

enterprises based upon a reasonable approximation of the division of profits that independent enterprises would have expected to realize from engaging in comparable transactions.” (§ 2.125 OECD Guidelines) “It can be difficult to determine the relative value of the contribution that each of the associated enterprises makes to the controlled transactions, and the approach will often depend on the facts and circumstances of each case. The determination might be made by comparing the nature and degree of each party’s contribution of differing types (for example, provision of services, development expenses incurred, capital invested) and assigning a percentage based upon the relative comparison and external market data.” (§ 2.126 OECD Guidelines)

“A residual analysis divides the combined profit from the controlled transactions under examination in two stages. In the first stage, each participant is allocated an arm’s length remuneration for its non-unique contributions in relation to the controlled transactions in which it is engaged. Ordinarily, this initial remuneration would be determined by applying one of the traditional transaction methods or a transactional net margin method, by reference to the remuneration of comparable transactions between independent enterprises. Thus, it would generally not account for the return that would be generated by any unique and valuable contribution by the participants. In the second stage, any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the facts and circumstances, following the guidance [...] for splitting the combined profits.” (§2.127 OECD Guidelines)

“An alternative approach to how to apply a residual analysis could seek to replicate the outcome of bargaining between independent enterprises in the free market.” (§ 2.128 OECD Guidelines) “In some cases an analysis could be performed, perhaps as part of a residual profit split or as a method of splitting profits in its own right, by taking into account the discounted cash flow to the parties to the controlled transactions over the anticipated life of the business.” (§2.129 OECD Guidelines)

“Generally, the combined profits to be split in a transactional profit split method are operating profits. Applying the transactional profit split in this manner ensures that both income and expenses of the MNE are attributed to the relevant related enterprise on a consistent basis.” (§ 2.137 OECD Guidelines)

## 6.7 Services

The general guidance provided by the OECD for applying the arm's length principle, as described above, pertains equally to the determination of transfer pricing between associated enterprises for the provision of intercompany services (referred to as "intra-group services" by the OECD). The OECD Guidelines state that, "often, the application of these guidelines will lead to use of the CUP or cost plus method for pricing intra-group services." (§ 7.31 OECD Guidelines) The OECD Guidelines provide the following guidance with respect to intercompany services.

### *Intragroup services*

"Intra-group services may vary considerably among MNE groups, as does the extent to which those activities provide a benefit, or an expected benefit to one or more group members." (§ 7.4 OECD Guidelines) "Under the arm's length principle, the question whether an intra-group service has been rendered when an activity is performed for one or more group members by another group member should depend on whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position.[...] 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 as an intra-group service under the arm's length principle." (§ 7.6 OECD Guidelines)

"[...], an intra-group activity may be performed relating to group members even though those group members do not need the activity (and would not be willing to pay for it were they independent enterprises)."(§ 7.9 OECD Guidelines) "In general, no intra-group service should be found for activities undertaken by one group member that merely duplicate a service that another group member is performing for itself, or that is being performed for such other group member by a third party." (§ 7.11 OECD Guidelines) "Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern." (§ 7.13 OECD Guidelines)

Some activities that independent companies would have been willing to pay for or to perform on their own, and therefore could be considered as intragroup services, are the following: “[...] administrative services such as planning, co-ordination, budgetary control, financial advice, accounting, auditing, legal, factoring, and computer services; financial services such as supervision of cash flows and solvency, capital increases, loan contracts, management of interest and exchange rate risks, and refinancing; assistance in the fields of production, buying, distribution, and marketing; and services in staff matters such as recruiting and training. Group service centres also often carry out order management, customer service and call centres, research and development or administer and protect intangible property for all or part of the MNE group.” (§ 7.14 OECD Guidelines)

#### *Arm’s length range*

“[...] the charge for intragroup services should be that which would have been made and accepted between independent enterprises in comparable circumstances.” (§ 7.19 OECD Guidelines) “A direct-charge method for charging for intra-group services can be difficult to apply in practice. [...] In some cases, an indirect charge method may be necessary due to the nature of the service being provided. One example is where the proportion of the value of the services rendered to the various entities cannot be quantified except on an approximate or estimated basis. [...] To satisfy the arm’s length principle, the allocation method chosen must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept.” (§ 7.23, 7.24 OECD Guidelines)

# 7 Economic Analysis

## 7.1 Transactions in the context lubricants production activity

### 7.1.1 Selection of the appropriate TP method

This section focuses on determining the appropriate transfer pricing method, as stipulated by the OECD Guidelines, to verify the arm's length nature of the intragroup transactions under examination.

#### *Comparable Uncontrolled Price method*

Applying the CUP method would imply the need of detecting highly similar transactions as the one under review, structured in the same way, either between one of the associated parties with independent parties (internal CUP) or between independent parties (external CUP). This means that there is the need to detect transactions where:

- LPC S.A. realizes transactions, under similar conditions and circumstances, with affiliated companies as well as with independent parties (internal CUP), or
- Affiliated companies realize transactions, under similar conditions and circumstances, with LPC S.A. as well as with independent parties (internal CUP), or
- Two independent parties engage, under similar conditions and circumstances, in similar transactions.

Accordingly, based upon the information available, it is reasonable to conclude that the CUP method cannot be reliably applied to evaluate the arm's length nature of the transactions under review due to the absence of comparable transactions.

#### *Resale Price method*

A proper application of the Resale Price method would require access to a high level of relevant information about third party transactions. No reliable internal or external comparable data can be identified for the case at hand. Therefore, the Resale Price method was rejected.

#### *Cost Plus method*

The Cost Plus method is ordinarily used in transactions involving the manufacture or assembly of goods for sale to related parties. This method also compares gross margins of controlled and uncontrolled transactions.

As already mentioned before, no reliable internal or external comparable data can be identified for the case at hand. Therefore, the Cost Plus method was also rejected.

#### *Transactional Profit Split method*

The application of the Residual Profit Split Method (RPSM) involves two steps. First, the operating income is distributed to each party in the controlled transactions to provide a market return for their routine contributions to the pertinent business activity. Second, any residual profit is divided among the controlled taxpayers based on the relative value of their contributions of any valuable intangible property to the relevant business activity. This method is best fitted for analyzing transactions entangling the contributions of highly valuable intangibles by more than one party to the tested transactions. The RPSM is not the most appropriate method for tangible goods transactions which do not involve valuable intangible transactions. Hence, this method will not be applied in the case at hand.

Regarding Comparable Profit Split Method (CPSM), transfer prices are derived from the profit split formula of uncontrolled taxpayers whose transactions and activities are similar to those of the tested controlled taxpayers. Under this method, the profit split ratio of the uncontrolled parties is used to allocate the combined operating profits or losses of the relevant business activity between the tested related parties. As the necessary external data showing comparable profit split to apply the CPSM is not available, CPSM cannot be applied to the case at hand.



The Contribution Analysis uses quantifiable and economically meaningful contribution factors such as certain expenses, number of relevant employees or amount of capital used, to divide total profit between two or more related-party entities involved in a transaction. Nevertheless, the use of this method would not be appropriate unless some reliable contribution factors that successfully correlate profitability of related parties are found.

In this case, there was not found any reliable contribution factor that correlates with the division of profit deriving from the transactions under review. Therefore, the PSM does not appear to be a reliable benchmarking method in the case at hand.

#### *Transactional Net Margin Method*

The comparability standards of the TNMM allow the use of a set of companies that have broadly similar functions and risks. European companies were identified, that perform broadly similar functions and incur similar risks, as LPC S.A., in relation to the transaction under review.

Moreover, since profitability at an operating level is generally less affected by differences in accounting standards than at a gross level, benchmarking at operating level usually proves to be much more reliable.

Therefore, the TNMM can be applied reliably to benchmark the arm's length character of the pricing policy of the transactions under examination.

#### *Aggregation of transactions*

According to OECD Guidelines (Chapter III, section A.3.1. on the "Evaluation of a taxpayer's separate and combined transactions", paragraph 3.9), "in order to arrive at a relatively precise approximation of arm's length conditions [...] there are often situations where separate transactions are so closely linked or continuous that they cannot be evaluated adequately on a separate basis."

The intragroup transactions in which the LPC S.A. participated in 2016 concerning:

- Sale of products,

- Receipt of intragroup Services,
- Purchase of raw materials,
- Other transactions.

Were all carried out within the context of LPC's commercial activity and provide a substantial contribution in company's business. Therefore, an examination of LPC's profitability from the aforementioned activity will provide a reasonable indication of the arm's length nature of the aggregated intragroup transactions.

## 7.1.2 Application of the appropriate method

### *7.1.2.1 Overview*

A reliable application of the TNMM requires:

- Selection of the tested party,
- Selection of years for comparison,
- Selection of an appropriate Profit Level Indicator (PLI).

### *7.1.2.2 Selection of the tested party*

Usually, the tested party will be the participant in the controlled transaction whose operating profit or margin attributable to the controlled transactions, can be verified using the most reliable data and requiring the fewest and most reliable adjustments and for which reliable data regarding uncontrolled comparable companies can be located. Generally, the tested party is the one with the least complex structure and functions and which does not own valuable intangibles.

The profitability of LPC S.A. can be more directly related to the intragroup transactions under examination. Therefore, is more reasonable to consider LPC S.A. as the tested party for the purposes of this analysis.

#### *7.1.2.3 Selection of years for comparison*

Data from multiple years usually must be considered when applying the TNMM. Generally three years of data are used, unless the specific facts of the case warrant a longer period.

If either the results or margin of the tested party falls within the arm's length range for the appropriate averaging period, the party is deemed to have satisfied the requirements of the TNMM. Accordingly, the tested party is compared to the comparable companies for the same period. The purpose of using 3-year weighted average is to smooth the impact of possible cyclical trends.

As far as the analysis in this case is concerned, data was chosen for the period of years 2013 – 2015.

#### *7.1.2.4 Selection of reliable comparable companies*

An extensive search for comparable manufacturers was performed using Amadeus database, which includes quantitative and qualitative data for more than 21 million companies all over the world.

24 independent companies were identified as comparable. The analysis concerning the steps followed and the criteria imposed on the search for comparable companies is included in Appendix I of this report.

The benchmark analysis examined financial data of the comparable companies from the period 2013 – 2015.

#### *7.1.2.5 Selection of an appropriate Profit Level Indicator*

A reliable application of TNMM requires the selection of a PLI which, taking into account all facts and circumstances, produces the most reliable measure of income the tested party would have earned had it dealt with related parties at arm's length. A PLI measures the return that a company realizes for its investment of resources and its assumption of risk.

### *Description of Profit Level Indicator*

Return On Total Costs (ROTC) was considered as the most appropriate Profit Level Indicator for the case at hand.

The return on total costs is the ratio of the operating profit to total costs (cost of sales, selling, general and administrative expenses as well as depreciation and amortization). Essentially, the ROTC indicates the return that should be earned on the resources employed as determined by the total costs incurred. Total costs include both direct costs and operating expenses and can be calculated if from sales subtract operating profit. Non-operating expenses, such as interest expense and income tax, are not included in total costs. By using total costs in the denominator, the classification issue between operating expenses and cost of sales is avoided. Further, by using operating profit in the numerator, it measures the return after expenses incurred in operating the business (except for the interest expense associated with financing the business). This measures the ROTC, which arise as a result of operating a business.

$$ROTC = \frac{\text{Operating Profit (EBIT)}}{\text{Total Costs}} \quad \text{where, Total Costs} = \text{Sales} - \text{Operating Profit (EBIT)}.$$

An independent manufacture, would seek to be remunerated for the costs incurred for the production of goods, while realizing a modest profit.

### 7.1.3 Conclusion

The resulting quartile range of 3-year (2013 – 2015) Weighted Average Return On Total Costs of the final comparable set is presented in the table below.

3/year Weighted Average 2013-2015	Minimum	1st Quartile	Median	3rd Quartile	Maximum	Number of comparable companies
ROTC	1.32%	3.40%	5.41%	8.32%	19.41%	24

*Table 4 Interquartile range of Weighted Average ROTC*

As presented in the table above, the benchmarking study produced an arm's length range of Weighted Average ROTC from 3.40% to 8.32% with a median of 5.41%.

Therefore, if LPC's ROTC realized during 2016 falls within the aforementioned interquartile range, then the application of the TNMM method provides sufficient information regarding the arm's length nature of intragroup transactions under examination.

In the table below present the calculation of the LPC's ROTC ratio:

LPC SA	
Operating Profit (EBIT) 2016	3,883,000
Sales 2016	66,728,000
Total Costs	62,845,000
<b>ROTC 2016</b>	<b>6.18%</b>

*Table 5 LPC S.A. ROTC 2016*

As shown above, the ROTC realized by LPC S.A. in the context of its main activity, was 6.18% so falls within the arm's length range.

Based on the results of the TNMM analysis it can be concluded that pricing of the intragroup transactions under review were carried out on terms that are in compliance with the arm's length principle.

## 8 Conclusion

In a globalized world transfer pricing is a key focal point for multinational enterprises. The establishment of appropriate transfer pricing policies is very important to ensure compliance with tax regulations and lessen the risk of incurring high penalties.

From the point of view of tax jurisdictions, inefficient Transfer Pricing could result in significant decrease of their tax revenues. In order to avoid this, intragroup transactions and transfer prices have come under increased scrutiny by the tax authorities during the last few years.

This only increases the importance of sophisticated Transfer Pricing documentation for multinational enterprises that strive to avoid exposures and penalties. Through the case of LPC S.A. we have demonstrated how Transfer Pricing documentation methodologies can be used to support the arm's length nature of intragroup transactions.

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### *Company Annual Report citation*

LPC S.A. (2017) 2016 LPC S.A. Annual Report. Aspropyrgos, Attica.

# Appendix I: Benchmarking Study

The search was conducted in the Amadeus database. Amadeus is an independent database of European companies provided by Bureau van Dijk. The database contains comprehensive information of over 21 million companies located in the European region. For this comparable search release 15.02 December 2017 version of Amadeus database was used.

Product name	Amadeus		
Update number	279		
Software version	15.02		
Data update	22/12/2017 (n° 2792)		
Username	LibUser1		
Export date	28/12/2017		
Cut off date	31/03		
		Step result	Search result
1. All active companies and companies with unknown situation		21,028,554	21,028,554
2. Region/Country/region in country: European Union [28], Norway, Switzerland		19,819,267	17,560,563
3. NACE Rev. 2 (Primary codes only): 1920 - Manufacture of refined petroleum products		3,654	1,403
4. BvD Independence indicator: A+, A, A-, B+, B, B-, U, Add companies for which all shareholders or all shareholders with a stake greater than 25% are individuals or employees		18,875,098	862
5. Type of accounts: U1 (companies with unconsolidated accounts only)		15,226,239	583
6. Year of incorporation: up to and including 2008		12,493,635	384
7. Years with available accounts: 2013, 2014, 2015		13,126,439	335
8. Operating revenue (Turnover) (th EUR): 2015, 2014, 2013, for all the selected periods, min=1,000, exclusion of companies with no recent or limited financial data		971,754	150
9. Operating P/L [=EBIT] (th EUR): 2015, 2014, 2013, for all the selected periods, min=0, exclusion of companies with no recent or limited financial data		3,344,340	120
Boolean search : 1 And 2 And 3 And 4 And 5 And 6 And 7 And 8 And 9			
		TOTAL	120

Figure 2 Search Strategy Amadeus database

- *Active Companies*

In order to ensure that the potentially comparable companies were not in liquidation or dormant, which could potentially distort their financial results, searched for companies that had active operations, i.e. screened for companies whose legal status was classified as “Active” by the Amadeus database. Moreover, companies whose legal status in the Amadeus database was unknown were included.

21,028,554 companies were considered as active companies,

- *Geographic Region*



A pan-European comparables set approach (European Union 28, also including Norway and Switzerland) has been undertaken in the search process. A Deloitte study<sup>2</sup> evidenced that the interquartile ranges for a pan-European comparables set are generally not statistically different from interquartile ranges formed by a set of companies from only one European country. Geographically, the undertaken statistical analyses covered only companies incorporated in one of the current member states of the European Union (Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom) as well as Norway and Switzerland.

This step resulted in 17,560,563 companies remaining in the comparable set.

- *Business activities- NACE Rev.2 industry classification code*

This criterion filtered out all companies whose activities were not comparable to the activities of LPC S.A. Thus, for the application of this criterion companies that were functionally similar to LPC S.A. were identified using an industry classification system<sup>3</sup>. In specific, NACE<sup>4</sup> Rev.2 code system was used. By picking targeted codes that closely matched the functions performed by the tested party all companies that were not likely to be comparable were excluded. The following code was selected:

NACE Code	Description
1920	Manufacture of refined petroleum products

Table 6 NACE Rev.2 industry classification code

The targeted code above is primary code (codes that reflect the primary –most important- activities rather than the secondary operations of the classified companies).

After the application of this criterion, the set was reduced to 1,403 potentially comparable companies.

<sup>2</sup> “Is Europe one market? A Transfer Pricing Economic Analysis of Pan-European Comparable Sets”, Deloitte White Paper, 2004

<sup>3</sup> The codes in an industry classification system classify companies by functions performed and products offered.

<sup>4</sup> Nomenclature générale des Activités économiques dans les Communautés Européennes (NACE) industry codes.

- *Independence I – BvD Independence Indicator*

It is important that the comparable companies are neither subsidiaries nor holding companies because transfer pricing potentially incompatible to arm's length principle might distort profitability. If this is the case, it is possible that the calculated Profit Level Indicator (PLI) does not represent an arm's length value. Thus, companies on the basis of their ownership characteristics were included. The database allows for determining the level of independence as a search criterion and this applies only to companies who have no shareholder with majority holding. In order to properly restrict the level of independence the following ratings were allowed: A+, A, A-, B+, B, B- and U<sup>5</sup>.

Moreover, all companies for which all shareholders belong to the categories: "one or more individuals or families" or "Employees/Managers/Directors" as well as companies for which all shareholders with a stake greater than 25% belong to categories "one or more individuals or families" or "Employees/Managers/Directors" were included.

As a result of the implementation of the above independence criterion, search set was narrowed to 862 companies.

- *Independence II - Type of accounts*

As stated above, it is important that the potentially comparable companies are independent and are not part of a group. In order to further secure the independency of the potentially comparable companies, the criterion for companies with unconsolidated accounts only was applied.

After the application of this criterion the set was reduced at 384 potentially comparable companies.

- *Year of incorporation*

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<sup>5</sup> The independence levels A+, A and A- indicate that no shareholder has more than 25% direct or total ownership, the levels B+, B and B – states that no shareholder recorded with more than 50% direct, indirect or total ownership and one or more shareholders recorded with more than 25% direct or total ownership. The level U stands for unknown level of independence.

Only companies that were incorporated up to and including 2008 were included in order to screen out development stage companies from the set of potentially comparable companies.

As a result of the application of this criterion, 384 potentially comparable companies were left in the set.

- *Availability of financial data*

The availability of recently published financial information would ensure that all companies were assessed in a rational manner. Thus, since the search was focused on years 2015, 2014, 2013 and screened for companies who had available reported financials in the database for said years.

This step resulted in 335 companies remaining in the comparable set.

- *Financial comparability I – Turnover screen*

In order to identify routine manufacturers of lubricants that operate in the European market, certain financial criteria were applied.

All companies who had an average turnover of less than 1 million Euro over the tested period (i.e. 2013 - 2015) were excluded.

150 potentially comparable companies were identified after the application of this criterion.

- *Financial comparability II – EBIT screen*

Finally, all companies who did not have available information (known values) with respect to their Operating P/L (EBIT) for the tested period (i.e. 2013 – 2015).

After the application of this last criterion in the Amadeus database, the set was reduced to 120 potentially comparable companies.

*Manual screening of the comparable set*

Amadeus search yielded an initial set of 120 potentially comparable companies. In order to further refine the initial set by adding criteria which cannot as consistently or flexibly be directly applied in the database, financial data were downloaded only for the years 2013-2015 for all companies in the initial set into Excel spreadsheet.

All remaining companies were screened in the internet and those companies whose website reviews indicated that they were engaged in activities significantly different than those of the tested party were excluded. Such non comparable activities included:

- Production and distribution of Liquefied Petroleum Gas (LPG),
- Production and sale of bitumen,
- Operation of petrol stations.

Furthermore, companies that did not have a website at the time the search was conducted as well as companies whose website was under construction or was dysfunctional or did not provide sufficient information in order to determine the type of activities which these companies were engaged in were also excluded.

The web search decreased the set of potential comparables to 24 companies. These appear to meet all the selected criteria and were deemed to be comparable to the operations of LPC S.A.

*Set of comparable companies*

No	Company name	Country name	Business description
8.	ROWE MINERALOELWERK GMBH	Germany	The company produces high quality oils (motor oils, multifunctional oils, greases, etc).
9.	CARL BECHEM GMBH	Germany	The company is manufacturer of industrial lubricants.
14.	GOTEBORGS SMORJMEDELSFABRIK (SCANLUBE) AKTIEBOLAG	Sweden	The company manufactures, stocks and distributes a wide range of lubricants.
18.	NILS SPA	Italy	The company manufactures lubricants.

22.	PAKELO MOTOR OIL S.R.L.	Italy	The company manufactures lubricants.
24.	ELDON'S S.A.	Greece	The company manufactures synthetic and mineral based lubricating oils, greases and special products.
25.	RILUB S.P.A.	Italy	The company is engaged in the production of lubricants.
26.	I.G.L.O.M. ITALIA S.P.A.	Italy	The company mixes, fills, produces and stores lubrication mineral oils and greases.
28.	VISCOL S.P.A.	Italy	The company manufactures lubricants.
39.	LUBRICA OOD	Bulgaria	The company manufactures motor, industrial and special oils.
40.	BERGOIL ITALIANA S.R.L.	Italy	The company is engaged in the production of lubricating oils.
55.	SYNECO S.P.A.	Italy	The company is engaged in research, production and marketing of synthetic base lubricants.
56.	SLIDER S.A.	Greece	The company is engaged in lubricant production for automotive, industrial, agricultural and marine applications.
58.	NOVA-STILMOIL SOCIETA' PER AZIONI	Italy	The company develops, produces and promotes chemical and petrochemical lubricants.
61.	SPECOL SP. Z O.O.	Poland	The company produces of a wide range of lubricants, operating fluids and petroleum products for automotive and agriculture industry.
63.	ALUCHEM - S.P.A.	Italy	The company produces synthetic lubricants.
66.	NUOVA UNIVERS S.R.L.	Italy	The company produces Industrial Oils, Synthetic Hydraulic Fluids, Transformer oils, etc.
75.	LABRIC S.R.L.	Italy	The company produces lubricants and chemical products.
89.	PRZEDSIĘBIORSTWO DOSWIADCZALNO-PRODUKCYJNE NAFTOCHEM SP. Z O.O.	Poland	The company produces lubricant oils, greases, etc.
90.	RS200 MOTOR OIL PAPANTONIOU S.A.	Greece	The company manufactures high quality lubricants and automotive chemicals.

94.	ROIL PETROLI S.R.L.	Italy	The company manufactures lubricants.
103.	DELTA OIL HELLAS S.A.	Greece	The company manufactures lubricants.
106.	ZANCOPE' S.R.L.	Italy	The company produces lubricants.
114.	LEIVADAROS, D., ACHAEAN LUBRICANTS S.A.	Greece	The company produces lubricants and greases.

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*Table 7 Set of comparable companies*

## Appendix II: LPC S.A. Financial Results



### LPC A.E.

#### Κατάσταση Οικονομικής Θέσης της 31<sup>ης</sup> Δεκεμβρίου 2016

(ποσά σε χιλ. Ευρώ)

		31.12.2016	31.12.2015
<b>ΕΝΕΡΓΗΤΙΚΟ</b>	<b>Σημ.</b>		
<b>Μη κυκλοφορούν ενεργητικό</b>			
Ενσώματα πάγια περιουσιακά στοιχεία	7	16.811	16.924
Άυλα περιουσιακά στοιχεία	8	2.320	2.362
Συμμετοχές σε θυγατρικές επιχειρήσεις	9	2.641	3.884
Συμμετοχές σε συγγενείς επιχειρήσεις	9	248	248
Πελάτες και λοιπές απαιτήσεις	10	1.045	319
		<u>23.065</u>	<u>23.737</u>
<b>Κυκλοφορούν ενεργητικό</b>			
Αποθέματα	11	10.530	8.783
Πελάτες και λοιπές απαιτήσεις	10	18.964	18.093
Ταμειακά διαθέσιμα και ισοδύναμα	12	4.702	4.081
		<u>34.196</u>	<u>30.957</u>
<b>Σύνολο ενεργητικού</b>		<u>57.261</u>	<u>54.694</u>
<b>ΙΔΙΑ ΚΕΦΑΛΑΙΑ</b>			
<b>Ίδια κεφάλαια αποδιδόμενα στους μετόχους</b>			
Μετοχικό κεφάλαιο	13	7.346	7.346
Αποθεματικά	14	14.587	14.587
Κέρδη εις νέον		895	(310)
<b>Σύνολο ιδίων κεφαλαίων</b>		<u>22.828</u>	<u>21.623</u>
<b>ΥΠΟΧΡΕΩΣΕΙΣ</b>			
<b>Μακροπρόθεσμες υποχρεώσεις</b>			
Δάνεια	15	17.437	-
Αναβαλλόμενες φορολογικές υποχρεώσεις	19	1.217	756
Υποχρεώσεις παροχών προσωπικού λόγω εξόδου από την υπηρεσία	20	2.855	2.983
		<u>21.509</u>	<u>3.739</u>
<b>Βραχυπρόθεσμες υποχρεώσεις</b>			
Προμηθευτές και λοιπές υποχρεώσεις	21	11.723	10.360
Τρέχουσες φορολογικές υποχρεώσεις		365	33
Δάνεια	15	836	18.939
		<u>12.924</u>	<u>29.332</u>
<b>Σύνολο υποχρεώσεων</b>		<u>34.433</u>	<u>33.071</u>
<b>Σύνολο ιδίων κεφαλαίων και υποχρεώσεων</b>		<u>57.261</u>	<u>54.694</u>

## Κατάσταση συνολικού εισοδήματος της χρήσης από 1 Ιανουαρίου – 31 Δεκεμβρίου 2016

(ποσά σε χιλ. Ευρώ)

	Σημ.	01.01.2016-31.12.2016	08.06.2015-31.12.2015
Κύκλος Εργασιών	26	66.728	32.272
Κόστος πωληθέντων	27	<u>(56.072)</u>	<u>(26.686)</u>
<b>Μικτά αποτελέσματα</b>		<b>10.656</b>	<b>5.586</b>
Εξοδα διάθεσης	27	(6.087)	(3.104)
Εξοδα διοίκησης	27	(2.395)	(1.907)
Εξοδα έρευνας & ανάπτυξης	27	(210)	(117)
Λοιπά λειτουργικά έσοδα / (έξοδα)	29	1.919	1.128
<b>Κέρδη εκμεταλλεύσεως</b>		<b>3.883</b>	<b>1.586</b>
Έσοδα από επενδύσεις	17	9	20
Χρηματοοικονομικά έξοδα	16	(1.304)	(713)
<b>Κέρδη προ φόρων</b>		<b>2.588</b>	<b>893</b>
Φόροι εισοδήματος	18	<u>(1.455)</u>	<u>(522)</u>
<b>Καθαρά κέρδη / (ζημίες) χρήσης μετά από φόρους</b>		<b><u>1.133</u></b>	<b><u>371</u></b>
<b>Λοιπά Συνολικά Εισοδήματα</b>			
Αναλογιστικά κέρδη / (ζημίες)	20	102	412
Αναβαλλόμενος φόρος	19	<u>(30)</u>	<u>(120)</u>
<b>Λοιπά Συνολικά Εισοδήματα</b>		<b>72</b>	<b>292</b>
<b>Συγκεντρωτικά Συνολικά Εισοδήματα</b>		<b><u>1.205</u></b>	<b>663</b>
<b>Κέρδη ανά μετοχή που αναλογούν στους μετόχους της εταιρείας για την χρήση (εκφρασμένα σε € ανά μετοχή)</b>			
Βασικά		<u>0,082</u>	<u>0,025</u>



**Κατάσταση ταμειακών ροών της χρήσης από 1 Ιανουαρίου – 31 Δεκεμβρίου 2016**

(ποσά σε χιλ. Ευρώ)

	01.01.2016 - 31.12.2016	08.06.2015 - 31.12.2015
<b><u>Λειτουργικές δραστηριότητες</u></b>		
Κέρδη προ φόρων	2.588	893
Πλέον / μείον προσαρμογές για:		
Αποσβέσεις	1.039	592
Προβλέψεις	(707)	(63)
Συναλλαγματικές διαφορές	(132)	(125)
Χρεωστικοί τόκοι και συναφή έξοδα /	1.162	693
Πιστωτικοί τόκοι και συναφή έσοδα	(9)	(0)
(Κέρδος) / Ζημία από πώληση παγίων	(12)	21
Πλέον/μείον προσαρμογές για μεταβολές λογαριασμών κεφαλαίου κίνησης ή που σχετίζονται με τις λειτουργικές δραστηριότητες:		
Μείωση/ (αύξηση) αποθεμάτων	(1.747)	(1.096)
Μείωση / (αύξηση) απαιτήσεων	(549)	1.687
(Μείωση) / αύξηση υποχρεώσεων (πλην τραπεζών)	1.251	(8.688)
Μείον:		
Χρεωστικοί τόκοι και συναφή έξοδα καταβεβλημένα	(1.094)	(750)
Καταβληθείσες αποζημιώσεις	(323)	(232)
Καταβεβλημένοι φόροι	(692)	(990)
<b>Σύνολο (εκροών) / εισροών από λειτουργικές δραστηριότητες (α)</b>	<b>775</b>	<b>(8.058)</b>
<b><u>Επενδυτικές δραστηριότητες</u></b>		
Αγορά ενσώματων και άυλων παγίων στοιχείων	(895)	(513)
Εισπράξεις από πωλήσεις ενσώματων και άυλων παγίων στοιχείων	24	-
Τόκοι εισπραχθέντες	9	20
Μείωση συμμετοχών	1.243	-
<b>Σύνολο (εκροών) / εισροών από επενδυτικές δραστηριότητες (β)</b>	<b>381</b>	<b>(493)</b>
<b><u>Χρηματοδοτικές δραστηριότητες</u></b>		
Εισπράξεις από εκδοθέντα / αναληφθέντα δάνεια	18.000	3.960
Εξοφλήσεις δανείων	(18.535)	(1.000)
<b>Σύνολο (εκροών) / εισροών από χρηματοδοτικές δραστηριότητες (γ)</b>	<b>(535)</b>	<b>2.960</b>
<b>Καθαρή (μείωση) / αύξηση στα ταμειακά διαθέσιμα και ισοδύναμα</b>	<b>621</b>	<b>(5.591)</b>
<b>χρήσης (α) + (β) +(γ)</b>		
<b>Ταμειακά διαθέσιμα και ισοδύναμα έναρξης χρήσεως</b>	<b>4.081</b>	<b>9.672</b>
<b>Ταμειακά διαθέσιμα και ισοδύναμα λήξης χρήσεως</b>	<b>4.702</b>	<b>4.081</b>