

Plenary Sessions 5-8 Case Study Iced Drinks Limited

Information from the 2014 and 2015 tax returns of Iced Drinks Limited

Taxpayer Name	Iced Drinks Limited	
Address	52 Bracino Way, Hopton, Country P	
Name of Ultimate Parent Company	Iced Drinks Holdings, Country A	
Description of main business activity	Manufacturing and sales of alcoholic beverages	
	2015	2014
Taxable income:		
Sales of goods and services	500	530
Deductible expenses:		
Cost of Goods Sold	400	410
Sales, distribution and marketing expenses	46	48
Management fees	6	6
Administrative expenses	3	4
Licence fees	40	42
Other deductible operating expenses	15	16
Profit before Interest and Taxes	-10	4

Other financial information

	2015	2014
Inventory	32	29
Trade and other receivables	18	19
Property, plant and equipment	50	51
Trade and other payables	11	10
Number of employees		
Sales division	33	32
Production division	75	74
Other	8	8

Iced Drinks Manufacturing

Information from the 2014 and 2015 tax returns of Iced Drinks Manufacturing

Taxpayer Name	Iced Drinks Manufacturing
Address	4 Bierfarejo Road, Maltville, Country Y
Name of Ultimate Parent Company	Iced Drinks Holdings, Country A

Description of main business activity	Manufacturing of alcoholic beverages	
	2015	2014
Taxable income:		
Sales of goods and services	105	100
Deductible expenses:		
Production related expenses	89	84
Management fees	6	6
Administrative expenses	2	2
Other deductible operating expenses	2	2
Profit before Interest and Taxes	6	6

Other financial information

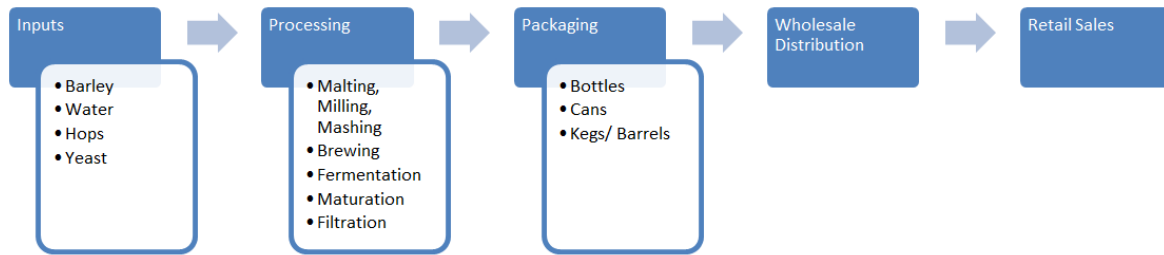
	2015	2014
Inventory	1	1
Trade and other receivables	5	6
Property, plant and equipment	51	50
Trade and other payables	2	2
Number of employees		
Production division	76	75
Other	15	15

Description of the Iced Drinks Group's business

Headquartered in Country A, the Iced Drinks Group is a multinational enterprise that manufactures and sells beer. The main brands sold by the group are "Ice Lager", "Ice Pilsner" (a premium beer), and "Cool Ale". The group company and its three brands are well established around the world. In addition, Iced Drinks Limited produces "Polar Beer", a well-established brand in Country P. Polar Beer is a beer flavoured with desert midyim berry (a fruit native to Country P). Polar Beer is not currently sold elsewhere in the world.

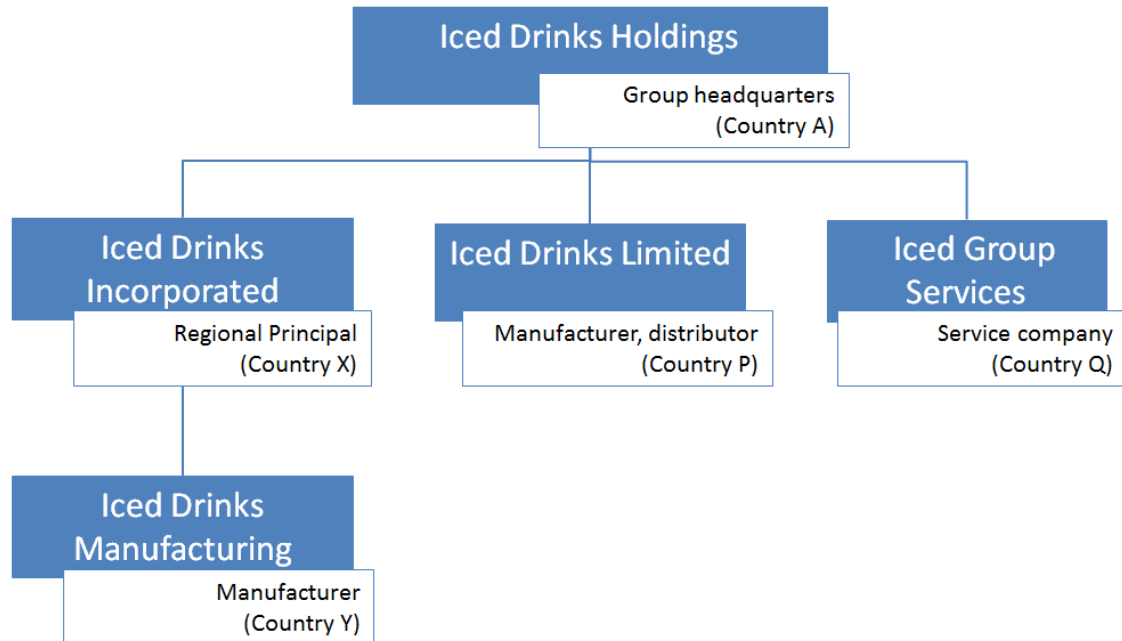
Supply chain

The diagram below outlines the key elements of the supply chain in relation to the Iced Drinks Group's beer products. The first stage is the procurement of high quality barley and hops. The first stage of processing, malting, involves soaking the barley in water so that the grains germinate, then drying in a kiln. Next, the grain is milled, mashed and strained to produce the wort; hops (and, in the case of Polar Beer, desert midyim berries) are added and the mixture is brewed. With the addition of yeast, the mixture then ferments and is left to mature to develop the flavour of the beer. The finished beer is then packaged into bottles, cans or barrels, ready for distribution and resale.



Organisational structure

The chart below illustrates the Iced Drinks group organisational structure.



Iced Drinks Limited is a manufacturer and distributor in Country P, where it has been operating for many years. It procures raw materials, produces and bottles beer in its breweries and bottling plants, and sells its products to arm's length customers.

Based on the long-term marketing strategy and other policy guidelines developed by Iced Beer Holdings IDL undertakes marketing, advertising and sales activities in Country P. It also uses its market information to forecast demand and undertake production scheduling. Over many years, IDL has built up a market for "Polar Beer", a brand it developed itself for the Country P market. "Polar Beer" is well-known and established in Country P, but is not currently marketed elsewhere in the world.

Iced Drinks Limited:

- translates the group's broad marketing guidelines into a marketing strategy for Country P;
- undertakes market research and demand forecasting, and from this establishes production targets and production schedules;
- has an exclusive licence to manufacture and sell "Iced" and "Cool" brand beers in Country P;
- has developed a market for "Polar Beer", and owns all the intangibles in relation to the Polar Beer brand;

- is responsible for procuring its supplies of barley, hops and desert midyim berries from unrelated parties (including sourcing suitable suppliers and negotiating contracts with them);
- owns a number of sophisticated breweries in Country P which it manufactures “Iced”, “Cool” and “Polar” brand beers;
- manages and owns inventories of raw materials, work in progress and finished goods; and
- sells finished products to resellers of Iced Drinks beers in Country P (including building and maintaining relationships with such resellers, negotiating sales contracts and providing after-sales support where necessary)

IDL has a licencing agreement with IDH which provides IDL with exclusive rights to make and sell “Iced beer”, “Iced Pilsner” and “Cool Ale”. It pays IDH a royalty of 10% of gross sales of these brands of beer.

IDL also has an agreement with IDS for the latter to provide it with management services. IDL pays IDS on a cost plus 5% basis for these services.

Iced Drinks Manufacturing, a subsidiary of Iced Drinks Incorporated is a manufacturer located in Country Y. It is contracted by Iced Drinks Incorporated to provide manufacturing services, specifically the production of “Iced” and “Cool” brand beers through its sophisticated breweries and bottling plants in Country Y. IDM undertakes quality control checks in line with its agreement with IDI. IDM relies on IDI for procurement of raw materials and production scheduling. IDM provides services to IDI in the form of information on market and growing conditions in relation to Country Y suppliers of hops and grain, and sales services support. It also conducts some market research activities in Country Y on behalf of IDI.

IDM uses a beer recipe supplied by IDI but also has access to best practices in brewing from other members of the Iced Drinks Group. Similarly, if IDM brewing staff develop best practices or process improvements, these are shared with others in the group.

IDM also receives management services from IDS, for which it pays on a Cost Plus 5% basis.

Key profit drivers

The most significant driver of the group’s business profits is the strength and success of the group’s beer brands, which are crucial to building and maintain sales. The success or otherwise of the brands is built on a reputation for quality, and the distinctive, consistent taste of each product. The group devotes substantial resources to marketing and advertising of brands. In addition, the group strives to build and maintain strong relationships with key customers, helping to ensure that Ice beers and Cool ales are widely available through retail outlets, and at restaurants, pubs, clubs and cafes.

In addition to demand-side factors, the other key profit driver for the group is its efficiency. By centrally managing a large part of its supply chain, from the procurement premium barley and hops, to encouraging all members of the group to share best-practices, particularly in key areas such as the brewing process. With strong competition in the industry, the beer manufacturing process is increasingly relying on technological advances such as greater automation and use of computerised monitoring in order increase efficiencies and drive down costs.

Market conditions

Globally, the beer manufacturing industry, and with it, the Iced Drinks group, has recorded reasonable growth in recent years, but with some volatility. Increasing consolidation in the industry has resulted in fierce competition in many markets. In developed markets, volumes have been flat as populations age and consumers switch to other alcoholic beverages. However, sales volumes in many emerging markets have experienced strong growth in recent years, generally driven by the increasing affordability of beer as consumers' disposable income rises. Expansion in these markets is seen as key to the growth strategy of the Iced Drinks Group over the next 10 years.

The Iced Drinks Group has responded to competitive pressures by re-focusing on its core business. In particular, it has strived to take control of all aspects of its supply chain in order to ensure it produces consistent, high quality, great tasting beer in all its markets.

Iced Drinks Holdings (IDH) is the holding company and global headquarters of the Iced Drinks group. It sets the strategic policy guidelines for the group's operations including establishing the group's long-term global marketing strategy.

Iced Drinks Incorporated (IDI) was established in 2013 to act as the group's principal in relation to its manufacturing and distribution activities in the XYZ region. In this capacity, it:

- translates the group's marketing strategy for the markets in the XYZ region;
- owns and controls the rights to use the trademarks and trade names "Iced" and "Cool" brand beers in the XYZ region;
- undertakes market research and demand forecasting, and from this establishes production targets and production schedules;
- procures supplies of barley and hops (including sourcing suitable suppliers and negotiating contracts with them);
- manages and owns inventories of raw materials, work in progress and finished goods; and
- sells finished products to resellers of Iced Drinks beers in the XYZ region (including building and maintaining relationships with such resellers, negotiating sales contracts and providing after-sales support where necessary).

Iced Group Services is the Iced Drinks Group's service centre. It provides management services to the group.

Sale of the Polar Beer brand

Thus far, Polar Beer, with its distinctive taste derived from the use of desert midyim berries, is only sold in Country P. IDL has successfully marketed Polar Beer in Country P for many years. The beer is marketed to take advantage of the desert midyim berry's reputation as a product unique to Country P, and one which thrives in the harsh environment of that country. IDL has promoted the brand through sponsorship of Country P's high-profile national football team. Polar beer commands a premium price.

Desert midyim berries are native to the high-altitude arid region of Country P and have not been successfully grown in a commercial setting elsewhere. Because of their naturally high antioxidant and acid levels, the berries must be added to the wort (together with the hops) within two days of harvesting or it impedes the later fermentation process. The berries are highly perishable and

difficult to transport. Moreover, the berries interact with the hops, reducing their isohumulone content (isohumulone inhibits the growth of Lactobacillus, which causes beer to spoil and turn sour), thus beers made with desert midyim berries are difficult to store or transport.

As part of the Iced Drinks Group's strategy to centralise management of intangibles, IDL sells the "Polar Beer" brand to IDH for a lump sum payment.

Further information

The R&D team in IDL develops a special freeze-drying process for desert midyim berries which allows the berries to be stored. This also means that the berries can be exported for use in beer production elsewhere in the world.

Marketing strategists in the Iced Drinks group are considering producing and marketing Polar Beer globally as a premium, healthy beer (due to its high anti-oxidant content).

Management fees

IGS provides both IDL and IDM with management services relating to the brewing and bottling process. The services provided include:

- Accounting and other administrative support
- HR support, including administration of payroll, provision of training
- Compliance assurance relating to regulatory standards
- Services supporting maintenance of brewing and bottling plant equipment, including related IT equipment (central logging of issues; provision of advice on repairs, maintenance, best practices; ordering of replacement parts as required)
- Services relating to health and safety standards for personnel operating in brewing and bottling plants
- Regulatory compliance services relating to environmental and health and safety standards for the brewing and bottling processes

As the group considers these to be low value-adding services, for simplicity it allocates the total cost of providing the services (with a 5% mark-up) on the basis of the number of beer production employees.