Transfer Pricing
Approaching and Aligning Intangible assets

Master’s thesis in Commercial and Tax Law (Tax Law)
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Abstract

OECDs transfer pricing regulations on intangible assets has been under an extensive scrutiny emanating in the BEPS projects action 8. The thesis purpose is to describe, analyze and discuss the project and its outcome on the area of valuation.

The most difficult area of the TPG rules on intangible assets is the valuation on the intra-group transactions of these assets, setting an arm’s length price. OECD started the project on intangible asset before BEPS, where the objective were to provide clarity within on the comparability aspect and valuation methods used to achieve the arm’s length principle, without adding more compliance burden on practitioners. When the BEPS-project was initiated the objective changed as to preventing BEPS by stating that profit from these transactions should be taxed where the value is created.

The report does not only address comparability aspects and valuation methods to be used, but also addressing other areas to achieve the objective, especially considering functionality analysis, risk allocations and other valuation methods to be used, when setting an arm’s length price.

Even though the report has clarified the TPG to some extent, regulations on how to achieve the arm’s length principle, both for comparability reasons as well as the valuation methods it has extended the scope of these aspect. By doing so the opens up for a more informative approach, giving tax authorities more insight in MNEs business operations. And by making both the comparability aspect and the usage of other valuation methods argumentative, the Action 8 outcome leaves the taxation of intangible assets transaction uncertain and non-transparent.
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Introduction

1.1 Background

As the business world becomes smaller in the sense of more multinational operating businesses and multinational enterprises operates globally, intangible assets move more and more across borders. Multinational Enterprises (MNEs) distribute their assets to different countries, in some countries they have productions, in another their base of distribution and in a third their research and development, and so on. Why they do this is based on a numbers of factors, but they are mostly economic. Due to this rapid globalization of moving assets and capital has led to an uncertainty for governments and tax authorities creating a potential risk of lost tax revenues. National tax law has not been able to adapt to this globalization creating situations of potential double non-taxation.\(^1\) It has also created great risk for companies leaving them with the uncertainty of tax fraud. As OECD states, this uncertainty "undermines the fairness and integrity of tax systems"\(^2\). For the reason of tax fraud, which most companies tries to avoid, companies that might not have the ownership of these assets might end up paying taxes for the revenues of these assets, for example when intangible assets are leased. Therefore the movement of intangible assets between related companies has become a risky and expensive transaction, both for the companies and for tax authorities.

It has been said that transactions of intangible assets is the most difficult and complicated area of transfer pricing regulations.\(^3\) These assets has increased in value for companies and as an effect of growing globalization as well as the recent financial crises, this market and its regulation has become more complex and important.\(^4\) Businesses and governments has for years, experienced difficulties with the treatment of intangible assets as there has not been any harmonized regulation on this matter and the OECD transfer pricing guidelines (hereinafter referred to as the TPG) has up until now not given enough direction on issues that the practitioner have had difficulties with. The consequence of these difficulties are that it leads to complex and monetarily-significant transfer pricing disputes with the result of either

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double or less-than-single taxation.\textsuperscript{5} Therefore further guidance on how to deal with these assets was asked upon the OECD to provide the MNEs to comply with. In July of 2010 the OECD started an extensive project to analyze the necessity of transfer pricing regulation on intangibles with the reason that this area has become ”a key area of concern for governments and taxpayers”\textsuperscript{6}.

The value of intangible assets is today significant for companies and for MNEs using these assets has become more beneficiary as it is tradable among the group. As the structure on MNEs allows them to move asset to parts of the MNEs where taxation of such assets is lower than in other parts it also creates opportunities to lower the costs for the MNE. This business structure is not an available option for independent businesses trading similar assets between them. This business structure may give MNEs the opportunity to use tax laws in a negative way.

In the transfer pricing regulations there is the key principle of that a price is to be set within a group organisation as it would be set between two independent parties, the price set is to be “at arm’s length”. To establish that price between two associated enterprises so that it correlates to the price between two independent enterprises, a comparison has to be done between the two situations, where certain factors or elements has to be compared. Problems in the comparability area has a huge impact on MNEs business as the arm’s length price is set for taxation reason and is used by tax authorities for taxation purposes. Therefore setting an arm’ length price impacts in MNEs business strategies and their effective trade.

Multinational companies has been dealing with this question and the risk at setting the wrong arm’s length price due to the lack of guidance on how to treat these situations. How would multinational companies be able to carry out business in this mandatory globalization and to practice on equal terms if no guidance is to be found on this matter?

The OECD project started in 2010 to answer this question, and just now in October 2015, the OCED concluded the final package on solving these matters, was published. The question is if it has solved the original questions of the valuation of intangible assets.

\textsuperscript{5} Transfer Pricing and Intangibles; the Scope of the OECD project, Center for Tax Policy and Administration, 25 January 2011, p. 2.

\textsuperscript{6} OECD invites comments on the scoping of its future project on the Transfer Pricing Aspects of Intangibles http://www.oecd.org/ctp/transfer-pricing/oecdinvitescommentsonthescoopingofitsfutureprojectontheextran-ferpricingaspectsofintangibles.htm
1.2  Purpose

The thesis has as purpose to describe, analyze and discuss one of the major problem areas within the OECD project on transfer pricing of intangible assets; the valuation aspect. As the handling of intangible assets has been under scrutiny by the OECD for some years the thesis has as objective to analyze the outcome of this scrutiny with focus on the valuation of intangibles in intra-group transactions.

The original problem defined is the relation of intangible assets and the fundamental arm’s length price which requires a comparability between set price in an uncontrolled transaction and in a controlled transaction of intangible assets. The thesis will review the questions and concerns companies had prior to the project, on how to compare intangible assets to establish a price that is sufficient at arm’s length, and whether the OECD project has been able to guide multinational companies in these questions. Has the valuation of intangible assets been defined in the OECD BEPS project and is it sufficient for companies to conduct a uniform practice?

The purpose of the thesis will emanate from a business perspective and from other interested parties as to show what the problems are of today’s regulation on the matter and what improvements (if any) in order to have an effectively trade of intangibles between group companies.

1.3  Method and Material

As the purpose of this thesis is to problematize a judicial problem not formally recognized in legislative text rather than a problem arising within a legal rule, the analysis will benefit methodological from a problem- and interest approach. The approach aims to use other means than the interpretation of a legal rule to understand the problem. This approach starts off with presenting an actual problem that effects the legal practices of international acting businesses, and then goes on explaining why this is a problem, who is affected by the problem and what kind of conflicts of interests there might be due to these problems. The analysis will have an explicative approach to the legal problems of intangible assets in transfer pricing

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7 Westberg, P., Avhandlingsskrivande och val av forskningsansats, Festskrift till Per Olof Bolding, Juristförlaget, 1992, s. 425.

8 Ibid (not 1) p. 425 f.
perspectives, meaning that problems and potential solutions will be described from background, meaning, purpose and consequences of these questions.

Materials and methods have been used in accordance with the perspective of the thesis and are chosen in accordance with the relevance for businesses. This is why OECD materials is used as the member countries as well as non-member countries uses this material as framework for international trade.

As this is a rather untouched area of transfer pricing regulations that has yet to be explored, materials used in this thesis is based on material from OECD in general material as well as articles and literature for the matter. As these rules are based on internationally adopted recommendations and the problem is not based on a defined legislation the Swedish taxation laws will only be briefly touched upon and when done only to show examples of how the recommendations are applicable in national context. The OECD regulations is mostly a recommendation to its member states even if it is currently used by national tax officials as domestic laws and regulations in international trade.

The OECD project of BEPS, has been ongoing since 2013, and the final report came out in October 2015. The OECD project on intangible assets has however been ongoing since 2010. During this time the OECD has issued draft report to be commented on by practitioners and other stakeholders. These drafts and comments has been used as a guidance of the questions as they have arisen, and how these as been dealt with. Not all of the draft has been used due to limited place and time. Focus has therefore been on the first drafts and comments from 2011 where the initial problem was stated. Then the development has been given room through the years where it is needed for explanatory purposes. The final outcome of the BEPS project, published in 2015, has been given most acknowledgement to see it the initial concerns has been at ease.

1.4 Delimitations

The thesis assume the reader has knowledge about the area of transfer pricing. Though, the thesis does explain basic aspects of transfer pricing, such as the arm’s length principle but it is only to understand the problems in relation to the valuation of intangibles.

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9 The final BEPS packages was released October 5, 2015
Even though this project concerns other big question marks, such as definition of the intangible asset, ownership etc., these questions will only be addressed in relation to its impact on the valuation of named assets. The reason for not addressing the definition aspect of this problem is that setting a cohesive international definition is just the start of solving the problem. When this aspect is finalized there is still a difficulty in the valuation of these assets whatever they are decided to become. So from the perspective of businesses and the issue of meeting tax claims this is delimited, but not at all less important.

The ownership aspect is part of the valuation aspect and important for the transaction itself. There are situations where transactions with intangible assets concerns one or more owners, for example in cost sharing agreements. For the purpose of this thesis the ownership question has been delimited because the valuation in regard to the arm’s length principle is not necessarily concerned with who is the owner even if it has great meaning to the next step – who is responsible for the tax consequence that might arise due to the valuation. Where the ownership questions has impact on the valuation it has been described in the thesis.

There is also a perspective issue in the transfer pricing aspects on intangibles which relates to whom the rules should apply, from the buyer or the seller? This aspect has been eliminated from the thesis mostly because it should not have a huge effect on the valuation or comparison of the assets. However, if there is some effect to the comparison or the valuation aspect that information is presented in the thesis.

Other issues relating to the purpose that is not in this thesis has been regarded as unnecessary due to lack of time and space and also for the concentration in the thesis.

1.5 Disposition

The second chapter of this thesis present where the problem arises and who is affected and in what way they are affected by conflicting or unclear rules. The chapter relates to how MNEs deals and value intangible assets. The reader has to understand why intangible assets is so important to companies and world trade. The chapter explains and pin point the differences in the treatment of intangible assets from a business- and economic perspective.

The third and fourth chapters problematize the transfer pricing rules concerning intangibles and explain why these rules became a problem. The third chapter explains the transfer pricing rules in general with focus on the arm’s length principle and transfer pricing in a business
perspective. The reason for this chapter is to understand what is to be achieved with a harmonized trade between the practitioners on the global market. The fourth chapter explains the transfer pricing rules with focus on intangibles assets as well as the transfer pricing methods used in the TPG to set an arm’s length price. The fourth chapter also introduce the problems with the TPG on intangibles.

The fifth chapter will present the OECD project that has as purpose to bring the problems presented in the earlier chapters to surface and which is currently being discussed internationally. The chapter will focus on the problems concerning the comparability requirement in the arm’s length principle. The OECD BEPS Project and its outcome will also be presented with focus on the area of valuation and the relation to the questions that was raised during the time of the project. This is the most important chapter of the thesis as this explains the question raised at the start of the project as well as the outcome.

The sixth chapter will analyze the project and the questions originally raised from the practitioners. It will analyze the objective and changes in the guidelines as well as the outcome of the BEPS project.

The last chapter (seven) is a conclusion of the findings in this thesis and even if the purpose of the thesis is not to provide any sort of solution to presented problem. Instead this chapter will try to point out where the outcome of the OECD intangible assets projects and if this outcome is sufficient enough, so that companies can continue to trade globally on equal terms no matter if they are a part of an associated entity or an independent party.
2 MNEs – Multinational Enterprises, the practitioners

2.1 Chapter Introduction

This chapter presents the practitioners that is influenced by the presented rules and recommendations. It is the MNEs that is effected by the guidelines and national legislation that is in accordance with these rules and are the practitioners who asked for help on how to treat these intangible assets. The information set out in this chapter is strictly from a business perspective and has as purpose to explain the reasons behind the dealing with intangibles, the importance of the assets value to the companies and how they plan their business around them in relation to the difficulties with compliance to the rules of international trade with these assets. The chapter starts with defining the MNEs and moves to the important of intangible assets in a business perspective, describing the transaction of these assets, the reason behind them and a little about how they affect the company’s economic perspective.

2.2 Multinational Enterprises – the practitioners

In order to understand the transactions made between the enterprises in a MNE, the actual business structure of MNEs has to be explained. Article 9 in MTC defines associated enterprises as ”where an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State”10. The globalisation has made it easy for companies to conduct cross border transactions and in MNE’s, this has given opportunities to transfer assets within the group, i.e. to subsidiaries in different countries with different jurisdictions.

Transaction within a MNE means that one segment of the organisation is charging another segment of the same organisation for a product or service that the first segment has supplied the second with, where both segments are situated in different countries.11 Or even simpler explained as ”[i]ntrafirm trade involv[ing] the sale or transfer of tangible and intangible goods between related companies in two or more countries.”.12 This is the concept of transfer pricing and it has its foundation in the structure of MNEs.

10 Article 9 of MTC 1.a.
11 Hubert Hamaeker Transfer Pricing lecture notes, Jönköping International Business School, 2010-03-03.
The purpose of transferring assets within an intra-group constellation such as MNEs, is probably and most certainly the advantages this brings. Both in terms of capability of transferring assets to a subsidiary in another country and the competitive advantages in the country, to gain market shares for example or to reduce costs for the purpose of increasing profits in another country. Parties within a MNE constellation has the advantages to move assets around or create value within the different parties of the MNE, allowing it to distribute profits and losses within the group where it is needed and to where it is most beneficial for the company as a whole. A company’s main goal is to make profit and being leading on the market it is represented within.

Due to the globalisation of trade the operation of an MNE has gone from country-specific to a more complex international operation, using matrix management to centralize functions within the MNE group. This type of operational management has made it easier to establish parties of the MNE group in locations distant from where the actual customer lives.\textsuperscript{13} Why this is even possible for MNE is for example the free movement of capital. As an example to where this can be exploited is where there is manufacturing party of the MNE. The manufacturer could be moved to a country where the labor costs is significant lower than in the country of the costumer or even the parent company’s country, which saves cost for the MNE but will not necessarily lower the profit when the product is sold.\textsuperscript{14} The product is then bought ”back” by a distributing party of the MNE in the customer’s country, creating a transaction within the MNE.

\subsection*{2.3 Intangibles in the business perspective}

Historically tangible asset has been most valuable for companies in the strive of revenues as these assets created the goods and services sold.\textsuperscript{15} However this is not the case anymore. In the last 20 years the importance of intangible assets has increased significantly for companies as the use of these assets has been given more and more room in the company’s annual

\begin{footnotesize}
\begin{enumerate}
\item Action Plan on Base Erosion and Profit Shifting, OECD 2013, p 7.
\item Ibid.
\item Verlinden, Mondelaers, ”Transfer Pricing aspects of intagibles: At the crossroads between legal, valuation, and transfer pricing issues.”, International Transfer Pricing Journal, January/February 2010, p. 49.
\end{enumerate}
\end{footnotesize}
reports. The reason for this is the fast growing globalisation, the corporate strive to productivity, competition and investment and of course increase revenues, and to archive success in these areas communication and rapid information sharing is the key factor.

Intangible assets has been difficult to define and especially depending on in what area the discussion take place. Within accounting, the International Valuation Standards Council (IVSC) has defined intangibles as "a non-monetary assets that manifest itself by its economic properties. It does not have physical substance but grants rights and economic benefits to its owner to the holder of an interest." For transfer pricing, the OECD definition has been rather vague but in the TPG it is referred to "intangible property” and includes the right to use industrial assets such as patents, trademarks, trade names, designs or models.” The list is not complete, as the guidelines continue that intangible property also include literary and artistic property rights, know-how and trade secrets. To further develop this definition the OECD also state that” [i]ntangible assets are assets that do not have a physical or financial embodiment”. What these two definitions make combined is that there are assets in a company that is not tangible but could have significant value to the company which may not show in the company report. It should also be noted that intangible assets are something that is able to be owned or controlled by someone for commercial use.

In order to understand the value of these assets and why they may create tax problems it is necessary to know what they are. What is it that create such value for multinational companies?

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17 Ibid.

18 International Valuation Standards Council, Guidance Note 4 Valuation of intangibles, revised 2010, p. 4 para. 2.3.

19 OECD TPG para 6.2.

20 Ibid.


22 Discussion draft, Revision of the Special considerations for intangibles in chapter VI of the OECD transfer pricing guidelines and related provisions, 2012, p. 7 para. 5.
The TPG gives guidance on some of the mentioned types of intangibles. Usually intangible assets are discussed in terms of commercial and market intangibles.\(^{23}\)

The category of commercial intangibles includes patents, know-how, designs to mention some.\(^{24}\) To understand the importance of commercial intangibles especially in a business perspective an example is given about patents. Patents grants the owner an exclusive legal right to use a given invention (either a physical good or a process) for a certain time period and usually within a certain geographical area.\(^{25}\) What needs to be kept in mind is the work behind the patent that the owner or the part of the MNE group that has developed it. As it concerns invention it is often a lot of work behind a patent and it is usually a result of a risky and costly research.\(^{26}\) Even though there is a lot of cost developing the invention the patent itself could be highly valuable for the company itself as it is the only company that would have the right to that invention for X amount of time. This is a huge competitive advantage.

Also, another commercial intangibles of high importance to the company is know-how and trade secrets. These intangibles are usually” […] undisclosed information of an industrial, commercial or scientific nature, arising from previous experience […]”\(^{27}\). This experience is usually well worked out and applied within the company organization and is depended on the confidentiality of the company employees and the company itself.\(^{28}\) Know-how and trade secrets are not protected in the same way as patents, even if some protection is given. These types of intangibles are also very valuable asset for companies as this is how a product or a process is worked out. If a company’s know-how or trade secrets were to be revealed the company might lose market shares within that certain area of expertise and potentially become bankrupt. Compare the recipe of Coca Cola and what might happen if that know-how would reach Pepsi (even though the Coca-Cola recipe is well protected by a lot of different intangibles such as patents, trade-marks etc.).

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23 OECD TPG para 6.3.
24 Ibid.
25 Discussion draft, Revision of the Special considerations for intangibles in chapter VI of the OECD transfer pricing guidelines and related provisions, 2012, p. 9 para. 15.
26 Ibid.
27 Ibid.
28 Discussion draft, Revision of the Special considerations for intangibles in chapter VI of the OECD transfer pricing guidelines and related provisions, 2012, p. 9 para. 16.
The other type of intangible refers to market intangibles such as trademarks, trade names, symbols, customer list, distribution channels etc.\textsuperscript{29} It is different assets or means to distinguish the company from others in the same area.\textsuperscript{30} Usually the trademarks, trade names etc. could be registered to be protected but it is no ”global” registration list and the company has to register within the markets it would like to carry out business but then it is usually protected as long as it is continuously used and the registration is renewed.\textsuperscript{31} The value in market intangibles is created by many factors but for certain reputation, credibility in both name and quality of the product or services for example. If the quality is under the customers’ expectations it could have a huge effect on the company name which in the end, might have effect on the company revenue. Trade names could also have effect on market penetration, as well-known companies might have an advantage in certain areas due to their reputation.

There is different types, beyond the mentioned above, of intangibles assets. However in this chapter it is not needed to list any further as the point of this part is to enlighten the economic aspects of intangible assets within a business. As described above these assets could have, and have had a great impact on companies’ profits. Intangible assets have a greater value to all kinds of businesses as these are assets that are not goods or services but generates value to companies that may not show in the balance report.\textsuperscript{32} Companies today, not only MNEs, has realized the importance of these assets and are putting a great amount of costs in developing these.

\textbf{2.4 Chapter conclusion}

The globalisation has provided MNEs with business opportunities to explore different markets and reach customers in different parts of the world. Transaction within the MNE group has given the opportunity to the advantages to move assets around or create value within the different parties of the MNE, allowing it to distribute profits and losses within the group where it is needed and to where it is most beneficial for the company as a whole. Transactions concerning intangible assets such as patents and trademarks has increased in the last two decades do to this globalization, creating value for companies that is not always shown in the

\textsuperscript{29} OECD TPG para 6.4.

\textsuperscript{30} Discussion draft, Revision of the Special considerations for intangibles in chapter VI of the OECD transfer pricing guidelines and related provisions, 2012, p. 9 para. 17.

\textsuperscript{31} Ibid.

\textsuperscript{32} OECD TPG para 6.2.
company’s reports. It has been difficult to make a clear definition of what intangible assets are and the definitions of these assets is dependent from the perspective, is it for accounting purposes or discussing transfers pricing. What could be agreed on is that these assets has a huge impact on the company profit when being traded especially when traded among the enterprises within a MNE group with the advantages this will bring.
3 Transfer Pricing

3.1 Chapter Introduction

With regard to the previous chapter, this chapter will outline the basic rules of transfer pricing and what is to be achieved with this regulation of global trade. The reader has to understand the transfer price and its current structure in order to understand the problems that this might be causing. In this chapter there will also be a presentation of transfer pricing rules from a business perspective. In order to understand the problems that intangible assets bring to the table, the fundamental goals of these rules has to be presented.

3.2 Transfer pricing introduction

MNE’s are trading among them self-moving assets from one entity in country A to another entity in country B, for many reasons as seen above. Transactions like these, between the enterprises in the different countries could create tax problems for both the MNEs and the governments that is affected by the transaction. The transactional opportunities mentioned in chapter 2 has led to that the MNEs can explore the legal aspects in each country and by that evaluate the area of tax planning, with a goal of minimizing their tax burden.33 These opportunities is a result of the free movements (within the EU) and it’s just natural for MNEs to explore these to lower their costs.

The reason for tax problems arising in these situations with intra-group trade is that the business constellation of MNEs has grown significantly in the last two decades and because of that the problems of taxation has increased with it.34 The taxation issue that arises for both parties is that MNEs is not just dealing with a separate country’s rules which would have isolated the problem itself, but now has to be addressed internationally.35 For MNEs these types of transactions, between two associated enterprises in different countries, can create extra administrative burden as laws and regulations differ from each other. These differences may lead to higher cost compliances and cause problems in the determination of

34 OECD TPG, preface 1.
35 Ibid.
income and expenses.\textsuperscript{36} This is contrary to the MNEs strive to lower the cost of the transaction, which is one of the MNEs goal.

For tax authorities and governments, these transactions might endanger the states sovereignty and make it hard to reconcile the legitimate right of taxation between the two countries involved.\textsuperscript{37} Even though the right to tax an entity of the MNE for the taxable profit arising within the country territory is reasonable, the government of that country also need to avoid that the same profit is taxed in the other country which is part of the transaction. This would mean that sometimes the countries has to give up tax income that might have arisen within their territory. Other problems for governments is that these transactions can hinder international transactions and the movement of capital.\textsuperscript{38}

These problems for both MNEs and governments has led to uncertainty about the allocation of revenues and costs of an entity within the MNE and how to combine compliance with business objectives.

What article 9 of the OECD Model Tax Convention (OECD MTC) aims at, is adjusting the profits occurring when assets are transferred between entities in an MNE group that has been or will be made for tax purposes.\textsuperscript{39} However it should be noted that these transactions can be made for tax evasion but that is not necessarily the case.\textsuperscript{40} MNEs has as described above, an advantage to shift profits to parts of the group that independent enterprises might not or where it would not be motivated for an independent enterprise to undertake a certain transaction that has occurred between associated enterprises.\textsuperscript{41}

The aim with TPG is to avoid the risk of tax distortion that might be a problem between associated enterprises and the tax authorities in the host country. This could be the case if market forces is not reflected in the transfer price that is set between the two associated

\textsuperscript{36} OECD TPG preface 2.
\textsuperscript{37} OECD TPG preface 3-4.
\textsuperscript{38} Ibid.
\textsuperscript{40} OECD TPG para 1.11
\textsuperscript{41} Ibid.
enterprises.\textsuperscript{42} Because of chosen business structure or model a MNE has set for its enterprises, the relationship between these enterprises might differ from what would have normally been between two independent enterprises. From a taxation point of view, this can distort competition and give business advantages that would not occur in a situation with independent enterprises.\textsuperscript{43} With this in mind and the aim with the guidelines on transfer pricing, the OECD member countries decided to apply a separate entity approach to intragroup transactions, meaning that individual enterprises in these groups had to ”be taxed on the basis that they act at arm’s length in their transactions with each other.	extsuperscript{44}\textsuperscript{44}.

\textbf{3.3 The arm’s length principle}

The arm’s length principle is an international standard accepted by the OECD member countries, which is to be used to determine the transfer price for tax purposes.\textsuperscript{45} In Article 9 this standard is stated as follows ”[where] conditions are made or imposed between the two 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 the enterprise and taxed accordingly.”\textsuperscript{46}

The principle aims at treating enterprises that is part of a MNE group and their transactions between each other, as separate entities trading with each other and by doing so making the adjustment of profits by reference to the conditions which would have been obtained between independent enterprises in a comparable transaction with comparable circumstances.\textsuperscript{47} By treating associated enterprises as independent in these transactions, allows focus on the nature of the transaction taken place and whether the conditions of that transaction is different from those that would have been obtained in a comparable transaction between two independent enterprises, i.e. the separate entity approach.\textsuperscript{48} Focusing on the nature of the

\begin{itemize}
\item \textsuperscript{42} OECD TPG para 1.3.
\item \textsuperscript{43} OECD TPG preface 6.
\item \textsuperscript{44} Ibid.
\item \textsuperscript{45} OECD TPG p. 23 under Glossary.
\item \textsuperscript{46} OECD MTC, article 9, 2010.
\item \textsuperscript{47} OECD TPG para. 1.6.
\item \textsuperscript{48} Ibid.
\end{itemize}
transaction and to compare that in both a controlled (between associated enterprises) and an uncontrolled (between independent enterprises) transactions, is called comparability analysis and is the foundation in the application of the arm’s length principle. This analysis concerns a lot of factors that needs to be considered and is different depending on the transaction taking place. Finding these comparable could be problematic. It is not a problem in a lot of transaction with tangible assets such as transactions with goods and some services as there is often certain fixed parts of these transactions such as market price, production costs etc. as there is often market for such things. However, the key factor is often that there is a tradable market to gather information on the planned transaction where dealing at arm’s length is not that much of a problem. The concerns arises where there is no comparable market for the transaction taking place, such as in the case of intangible assets even though these assets are tradable. The comparability aspect will be discussed further in later chapters.

Even in trade with tangible assets it can sometimes be difficult to reflect the market price where there is a lack of such or if a special commercial strategy prevents such comparison. In these cases OECD state that adjustments can be made in order to comply with the arm’s length principle, these adjustments are however only acceptable where there is a tax purpose with aim of correcting a tax distortion. It has also been stated how appropriate adjustments is achieved, "by establishing the conditions of the commercial and financial relations that they [the trading associated enterprises] would expect to find between independent enterprises in comparable transactions under comparable circumstances", which is basically a description again of the arm’s length principle.

There are though some problems with applying the arm’s length principle between intra-group transactions because there are transactions between associated enterprises that independent enterprises would not undertake, which means that there is no comparable transaction for estimation of an acceptable transfer price. The reason is that there would be no indicators that the conditions made would have been established between the independent enterprises, and as OECD is writing in their guidelines "[t]he mere fact that a transaction

49 OECD TPG para. 1.6.
50 OECD TPG para. 1.3.
51 Ibid.
52 OECD TPG para. 1.11
may not be found between independent enterprises does not of itself mean that it is not arm’s length." \(^{53}\)

So, the reason for the arm’s length principle and the separate entity approach is that it provides equality in tax treatment for these types of entities, as it helps avoid the creation of tax advantages or disadvantages that could distort the competitiveness between these types of entities. By separating tax considerations from economic decisions there can be more focus and promotion of growing international trade and investment. \(^{54}\)

### 3.4 Transfer pricing in a Business perspective

What has to be kept in mind is that the intra-group trade is an economic decision regarding the whole group of enterprises and a reason to become a multinational co-operation. There is a lot of practical and economic reasons for setting a transfer price on intra-group transactions but there is also the fact that these practical and economic reasons has to comply with tax regulations. These regulations put pressure on MNEs to comply with these regulations because if they don’t they risk fines and reputations. \(^{55}\) In literature this problem is called ”corporate transfer pricing problem” \(^{56}\) and what it refer to is the requirement that is put on MNEs to implant policies and practices which will ”satisfy the needs of the business with respect to strategy and internal incentives, result in an efficient use of resources, and provide an appropriate transfer pricing answer from a tax perspective.” \(^{57}\)

Transfer pricing in an economical definition is similar to the OECD definition, described as follow; ”a transfer price is considered as the amount that is charged by a part or segment of an organisation for a product, asset or service that it supplied to another part or segment of the same organisation” \(^{58}\). Why enterprises in an MNEs set a transfer price for intra-group trade has many different reasons, one being that charging a transfer price gives the opportunity to evaluate the performance of the group entities that is concerned while another rea-

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\(^{53}\) OECD TPG para. 1.11

\(^{54}\) OECD TPG para. 1.8


\(^{58}\) Dr G. Cottani, *Transfer Pricing*, IBFD online transfer pricing database, 2015, p. 27.
son is that, by charging transactions of goods and services between group entities, management can make decisions on whether it is more suitable to buy or sell goods inside the group or outside.\(^{59}\) A third reason and aspect for MNEs to use transfer pricing is that it allows reasonable allocation of financial means to the different part of the MNE.\(^{60}\) These reasons are only a few but what it all points at is that the transfer price works as a control function to see the financial state of the MNEs and because of the taxation aspect of it, MNEs now has to find a way that will work both for the sake of tax purposes and with respect to the most suitable corporate strategy.\(^{61}\)

Setting a transfer price allows MNEs to shift profits from high-tax jurisdictions to jurisdictions with low tax rates which implies an opportunity for tax planning.\(^{62}\) It is a strategic aspect of the business of MNEs to use transfer pricing and because of that, it has been discussed whether this is a chance to avoid tax for these kind of businesses. However, even if there is that possibility, it is not the only reason for setting a transfer price in intra-group trade, as seen above. Even though tax planning is a consideration when it comes to transfer pricing, it is not the case for many of the operating MNEs, but neglecting such consideration, is not preferred.

What the tax regulations shows and what has to be regarded in the business planning of MNEs has increased a lot since the mid 1990’s.\(^{63}\) The dealing at arm’s length principle has meant that MNEs has to regard third party data when setting a transfer price for transaction of assets within the corporation. Requiring third party data is expensive for MNEs and takes a lot of time. But when it is about intangible assets there is no guarantee that there is such data to find, which results in even more work and finances to comply with these rules.\(^{64}\)

From a business perspective intra-group transactions is about selling and moving value between the associated enterprises, just like it would be if same or similar transaction was made between an enterprise in the group and an independent enterprise. Setting a transfer price is

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\(^{60}\) H. Hamaekers, *Introduction to Transfer Pricing*, 2001, p.3


\(^{62}\) Dr G. Cottani, *Transfer Pricing*, IBFD online transfer pricing database, 2015 p. 29.

\(^{63}\) Dr G. Cottani, *Transfer Pricing*, IBFD online transfer pricing database, 2015, p. 28.

about meeting both tax regulations in the affected countries and at the same time meeting the business strategy and goal.

The reason for this chapter is to understand how and why there is a transfer price set for transactions between associated enterprises from a business perspective. Transfer pricing is a strategic move for MNEs, but lately there has been changes in the global market for intangibles that does not comply with existing guidelines that meet the tax regulation requirements. The question is how to join the tax and business perspective, so that they contribute to the expansion of world trade and achieve the highest sustainable growth.

3.5 Chapter conclusion

Transfer pricing regulations has as goal to ease MNEs transaction with associated enterprises in different countries by setting regulations that avoids double taxation. These types of transactions creates tax problems for both tax authorities and MNEs and can also give opportunity to tax distortion why these regulations exist, to try to prevent these actions. OECD and its member countries has stated the arm’s length principle that helps both MNEs and tax authorities to control and set a transfer price on assets as they should have been set between independent enterprises and by that prevent tax distortion within associated enterprises. By doing so allows focus on the nature of the transaction and the conditions of it. To achieve an arm’s length price the conditions have to be compared to a similar transaction between independent enterprises, this is called the comparability analysis and is the core in the arm’s length principle. The comparability can be tricky especially in the circumstances of transactions with intangibles as there is no open market that is trading this type of asset. From a business perspective setting a transfer price is an economic decision, one of them being to comply with tax legislation but also to evaluate performances within the MNE etc. And it it’s not often that big MNEs want to use the opportunity of tax evasion. But in order to comply with rules and regulation such as the arm’s length principle MNEs need to put a lot of money in the search to the right thing. MNEs need to understand the rules and recommendations to be able to meet legislation and their own business strategies.
4 Transfer Pricing Guidelines on intangibles

4.1 Chapter introduction

Transfer pricing on intangible assets has led to many problems as of applying the rules to real business situations. These rules and requirement that controls transactions with intangibles are presented by the OECD as follows starting with an explanation of these assets.

4.2 Intangible assets

As stated transactions that involves intangible assets is one of the most problematic areas of transfer pricing. The reason is that, these type of transaction has lacked international cohesive guidance, such as clear definition of the intangible asset, ownership and comparable which means that it is more difficult to set an arm’s length price. Until now there has been no common definition of what intangible assets are but OECD has, in their guidelines on behalf for their member countries, defined the term intangibles as including the rights to use industrial assets, meaning patents, trademarks, trade names, designs or models, but also literary and artistic property rights and intellectual property rights specifically know-how and trade secrets. This definition is what many of the OECD member countries has relayed on as not many has own definition of intangible assets, but even if that will provide some sort of cohesiveness it has been said that even this definition is not enough. The definition previously used by OECD will be applied in this thesis as compared to the outcome of the project of OECD that will be scrutinized.

However in accounting aspects there is a more common definition, IAS 38 defines intangibles assets as ”an identifiable non-monetary asset without physical substance” where identifiable means when the asset is ”capable to being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability or [when it] arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other

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67 OECD TPG para. 6.2.

68 H. Hamaekers, Introduction to Transfer Pricing, 2001, p 86.

As seen above intra-group transaction has to comply with the arm’s length principle for tax reason and transactions with intangible assets are no exception. But this transaction is more difficult to evaluate for those reasons. There has to be appropriate methods to establish the arm’s length price because of not only the tax reason but for the MNE trading these assets within the group. Intangible assets provides a great value to the companies even though they might not have a book value in the balance sheet.

To make a difficult problem even more problematic intangible assets has been divided in to two sub groups as seen in chapter 2, commercial or trade intangible and marketing intangibles. The first group regards patents, know-how, designs and models as well as intangible rights that are transferred business assets to third parties, such as customers. These trade intangibles has the character of being risky and costly as they refers to R&D activities and the transactions with these has as goal to recover those costs.

The second sub-group includes trademarks and trade names that has an impact on the commercial exploitation of a product or service sold. These assets are of important promotional value to the companies and product concerned. The value depends on various factors such as reputation, creditability, quality of both trade name products and services, ongoing R&D, distribution and availability etc. All to ensure trade name and trademark recognition. Trade secrets and know-how can be part of both sub-groups as it is referred to as "proprietary information or knowledge" which will assist in the making of commercial intangible assets but will not be under the same legal protection as marketing intangibles.

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71 OECD TPG para. 6.1.
72 OECD TPG para. 6.2.
73 OECD TPG para. 6.3.
74 OECD TPG para. 6.4.
75 OECD TPG para. 6.4.
76 OECD TPG para. 6.5.
77 OECD TPG para. 6.5.
It is not difficult to understand that these types of assets have great value to the companies and that having clearer guidance in these matters would be helpful. Next sub-chapter will discuss the existing rules regarding transfer pricing on intangibles.

4.3 Transfer pricing regulation Article 9

Article 9 of the OECD MTC states the arm’s length principle (see 2.3) which is the foundation to all transfer pricing arrangements. In this article not much information on how to apply this principle on real situations can be found on either tangible or intangible assets, why OECD TPG is needed. Even though there is much information for applying these rules on tangible assets such as goods and services, it is rather the opposite for intangible assets. However, there is a chapter in these guidelines on the approach to intangible assets named Special considerations for intangible property.\(^78\)

Applying the arm’s length principle means from an article 9 perspective to compare the conditions of a transaction taken between entities in MNEs to a similar transaction taken between two unrelated parties.\(^79\) The reason for doing so to focus on the nature of the transaction which should have the same effect in both an uncontrolled and controlled transaction.\(^80\)

However, this comparison can be difficult to make as seen above in chapter 3. Some transaction made between the entities in MNEs are based on commercial circumstances that makes it difficult to compare to as there is no certainty that these circumstances would have been under the same conditions in trade between independent enterprises. This statement is found in the OECD TPG and is followed by the comment that ”the mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm’s length”\(^81\). So if there is no comparable transaction taken between independent enterprises, but the arm’s length principle still needs to be intact, how would businesses, in this case MNEs, know what an arm’s length price would be? This is a question that will arise in transactions with intangible assets as these can be unique and totally dependent on the product it refers to.

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\(^78\) OECD TPG, chapter 6.

\(^79\) OECD TPG para. 1.33.

\(^80\) OECD TPG para. 1.6.

\(^81\) OECD TPG para. 1.11.
It is said that the arm’s length principle is difficult to apply to controlled transactions with intangible assets.\textsuperscript{82} This is so because of the comparability aspect of these transactions; there is not enough accessible information of doing this comparison. Even if article 9 include transactions with intangible assets these are under the same requirements as tangible assets even though it is two completely different transactions for the businesses as seen above, chapter 3.4.

The guidelines to this article describes different methods for establishing an arm’s length price depending on the comparable available and the type of transaction. These methods will be described from an intangible assets perspective further down in the thesis but it is worth mentioning here as these methods are important in order to understand article 9 and the determination of an arm’s length price.

\section*{4.4 Special considerations for intangible assets}

\subsection*{4.4.1 Applying the arm’s length principle}

The TPG acknowledge the difficulties or rather the special considerations the trading of intangible assets has, especially for being compliant to the transfer guiding rules that MNEs needs to be today. The reason is that ”[…] intangible property transactions […] are often difficult to evaluate for tax purposes”.\textsuperscript{83} Therefore the set out in Chapter VI of the TPG aims at providing guidance on the application of appropriate methods to an acceptable arm’s length transfer price for these transactions.

The general goal with the arm’s length principle is that price set on an intra-group transaction should be comparable to the price set between two unrelated parties where the transaction itself is the same or at least could be considered as the same, and then tax accordingly. To do so the OECD has provided guidelines for MNEs to achieve this.\textsuperscript{84} This relates to all kind of transactions between MNEs, which includes transactions with intangible assets.\textsuperscript{85} However, at the same time the TPG states that applying this principle is difficult in setting a

\begin{footnotesize}
\textsuperscript{82} Dr G. Cottani, \textit{Transfer Pricing}, IBFD online transfer pricing database, 2015, p. 120.

\textsuperscript{83} OECD TPG para. 6.1.

\textsuperscript{84} OECD TPG Chapter 1.

\textsuperscript{85} OECD TPG para. 6.13.
\end{footnotesize}
transfer price for transactions with intangible assets. To set a price that is comparable to the price of non-related enterprises and that is the difficult part, to find comparable transactions.

As previously stated intangible assets has special characteristics for each kind of asset it is as well as for the MNEs, which make them harder to compare. The TPG gives examples of what could be included in a transaction in an intangible asset which making them different from other transactions of the same kind. It could of curse be outright sale, or royalties under licensing arrangements, but it could also be more complicated transactions such as package of bundled intangibles, know-how contracts etc. What is interesting from a valuation point of view is what is included in the transaction price and if there is an unrelated party that sold a same or similar (comparable?) asset of which the price in the first transaction could be compared to.

The TPG states that in order to apply ”the arm’s length principle to a controlled transactions involving intangible property, some special factors relevant to comparability between the controlled and uncontrolled transaction should be considered.” In the next subchapter the comparability requirement will be explained and special focus will be put on the TPG for the special factor that needs to be acknowledged for comparability of intangible assets.

4.4.2 Comparability analysis requirement

As described in chapter 3.3 the comparability analysis is the foundation in the arm’s length principle. The price received by the selling entity for the sold intangible assets shall then be calculated in accordance with the arm’s length principle which should be decided through the comparability to an identical or similar third party transaction. There are five comparability factors in the TPG that is considered to be of most importance in the comparability

86 Ibid.
87 OECD TPG para 6.13.
88 OCED TPG para 6.28.
89 For example please see OECD TPG para 6.16-6.19.
90 Ibid.
91 OCED TPG para. 6.20.
analysis, these are the assets features, the functional-, risk- and asset analysis, and the conditions of the contract, the economic circumstances and the business strategic behind the transaction.\textsuperscript{93} So how this comparability analysis is done is very important to set a correct transfer price that will meet the arm’s length requirement. For both tangible and intangible assets the guidelines dedicates a whole chapter\textsuperscript{94} to this analysis.

The comparison has two parts that is to be compared to each other, one being the controlled transaction between the associated enterprises and the uncontrolled transaction that is working as a potential comparable.\textsuperscript{95} The aim with the comparability analysis is to find a comparable that will be most reliable for the controlled transaction, where several uncontrolled transaction are scrutinized and eliminated after the degree of comparability to other uncontrolled transactions that has higher degree of comparability to the controlled transaction.\textsuperscript{96} This can be a very daunting task for MNEs to find uncontrolled transactions that would cover all comparable factors but the guidelines do state that there is no requirement for an exhaustive search and OECD do acknowledge that there are limitations in availability in information and that searching for comparable are a burden for businesses.\textsuperscript{97}

The process of a comparable analysis is also described in the guidelines, but the presented process is considered as an acceptable practice but not as compulsory. First there is a determination of timeline that the comparable should be in. Second a broad-based analysis of the taxpayer’s circumstances is made followed by an examination of the controlled transaction with focus on functional, risk- and assets analysis. This third step is done to choose the tested party (the party that should be used as a comparable), the appropriate transfer pricing method, and the financial indicator that should be tested meaning the price that should be set and to identify the significant comparability factors so the arm’s length price would be right. The forth step is to find and review existing internal comparable if there is any, and in that case it should be between the company and a third party. The fifth step is to find and determine available information sources in external comparable. After examine these previous steps the most appropriate transfer pricing method should be chosen. The next step is

\begin{itemize}
\item \textsuperscript{93} Skattehandboken 2012, p. 480.
\item \textsuperscript{94} OECD TPG, chapter 2.
\item \textsuperscript{95} OECD TPG para. 3.1.
\item \textsuperscript{96} OECD T para. 3.2.
\item \textsuperscript{97} Ibid.
\end{itemize}
to find potential comparable by determine key characteristics that is to be compared to an uncontrolled transaction and its conditions. The eight step allows for adjustments that might be needed and where it is appropriate. The final step is to determine the correct arm’s length remuneration by interpret the data collected by the previous steps. 98

These steps provide analysis of the segment and industry, competition, economic factors regulations that have effect on the business (step 2), a definition of the internal transaction by asking if there is both tangible and intangible assets in the transaction and in that case what refers to what (step 3). 99 It also involve finding sources with information on external comparable transactions (step 5). Commercial databases are often used for this purpose but they are limited as they might not contain detailed information and may vary from country to country depending on the national requirements. 100

Identifying external comparable are done by two approaches. In the first approach a person who performs the search makes a list of parties that are likely to preform potential comparable transaction. By using information on these parties’ transactions, it can be confirmed if the transactions can be used as comparable based on pre-determined criteria that has been decided when examine the internal transaction. 101 The advantages with this approach is that it gives well-based results as they are based on by players within the taxpayers market and it does not need any other support if the person conducting the analysis has good knowledge about a few players within the taxpayers market.

The other approach has a different analysis where a list of companies that operates in the same sector, perform similar broad functions and do not present obviously different economic characteristics to the taxpayer, is refined and slimmed down by using selection criteria and official information to find comparable transactions. 102 The advantage with this approach is that it is easy to reproduce and more transparent then the first approach. 103 But even if

98 OECD TPG para. 3.4 and Skattehandboken 2012.
100 Skattehandboken 2012, p. 284.
101 OECD TPG para. 3.41.
102 OECD TPG para. 3.42.
103 OECD TPG para. 3.44.
there are advantages there are no recommendations in the guidelines on which of the approaches that is to be preferred and it is said that these approaches are not used exclusively.\textsuperscript{104}

Even if these factors are relevant to consider when comparing the transaction taken to an uncontrolled similar transaction in order to establish the arm’s length price, there is other factors that has to be consider when dealing with intangibles.\textsuperscript{105} As these are difficult transactions that includes many different variables there is an uncertainty that there even is a comparable situation between independent enterprises. This is due to the special character that these assets might have which complicates the search for comparable and by that makes it harder to determine a value on the transaction at the time for the controlled transaction.\textsuperscript{106}

Such factors can be the expected use of the intangible asset, which can be decided by numerous present value methods, the geographic limitation that the intangible can be used in, export restrictions, how exclusive it is considered to be, cost for the investment, the opportunity to sub-licensing, and if the licensor should have right to future developments.\textsuperscript{107}

So there are several other factors that has to be considered when the transaction involve intangible assets, which puts even greater burdens on MNEs to find and examine information in order to set an arm’s length price. However the factors are not an exclusive group and there are many different factors that are not mentioned within the guidelines. This creates an uncertainty of which factors are important and how businesses should relate to these factors.

\textbf{4.4.3 Transfer pricing methods}

The valuation of intangible assets are done by the usage of acceptable transfer pricing methods. However when it comes to the valuation of intangibles the transfer pricing method used has to be compared to a similar transaction between independent parties to see if the price set by the method used is to considered as at arm’s length.

There are five different transfer pricing methods used to determine an acceptable price, the Comparable Uncontrolled Price Method (CUP), Resale price method, Cost plus method,

\begin{itemize}
\item \textsuperscript{104} OECD TPG para. 3.45.
\item \textsuperscript{105} OECD TPG para 6.20.
\item \textsuperscript{106} OECD TPG para. 6.28.
\item \textsuperscript{107} Skattehandboken 2012, p. 486.
\end{itemize}
Profit split method and Transactional Net Margin Method (TNMM). These methods are used on both tangible and intangible assets.\(^{108}\) Finding the right or most accurate method for intangible assets is very difficult as the assets are not straightforward as tangible assets and this is because of the uniqueness described above. Depending on the type of assets there is more or less factors that speak for a method to use. In the TPG chapter 6 there are no special consideration to which of the methods should be used on transactions with intangibles. However, the examples given in this chapter seems to lean towards the CUP method as a preferable method even though methods such as resale price and cost plus could be used.\(^{109}\) The CUP method compares the price charged for a property sold within the MNE group to the price charged for same or similar product between independent parties.\(^{110}\) The requirement is that there is a comparable uncontrolled transaction to compare the set price to. So where a comparable uncontrolled transaction is identified the method can be used to compare the set price in the intra-group transaction of the similar intangible assets. However, as intangible assets are mostly unique to their characteristics, it is very difficult to find comparable transactions between independent parties. Chapter 2 in the Guidelines state that in the cases where there are no reliable information about uncontrolled transactions it is better to use transactional profit split method such as the TNMM and Profit split methods.\(^{111}\) Though the TPG state that in terms of intangibles and where these are highly valuable the Profit split method is preferred. Profit Split compares the profit margins “that an independent enterprise would have expected to realize from engaging in the transaction”.\(^{112}\)

There is also the opportunity for MNEs to use other valuation methods outside the ones stated in the TPG, which would satisfy the arm’s length principle.\(^{113}\) Which methods that can be used instead is not listed, but the TPG state that these are not intendant to substitute the above five, but be used when the acknowledge methods does not give an appropriate

\(^{108}\) OECD TPG para. 2.2.

\(^{109}\) OECD TPG para. 6.22–6.24

\(^{110}\) OECD TPG para. 2.13.

\(^{111}\) OECD TPG para. 2.4

\(^{112}\) OECD TPG para. 2.108.

\(^{113}\) OECD TPG para. 2.9
arm’s length price. It is also stated that when applying this paragraph the MNEs need to explain why the chosen method is preferable over the acknowledged five.\footnote{114}

\subsection*{4.4.4 Concerns with the guidance in the TPG chapter 6}

The guidelines regarding transfer pricing aspects on intangible assets are concentrated on the arm’s length principle and the comparability analysis and the valuation of these assets. At the OECD meetings in March and November 2011 practitioners presented their material regarding this question. Concerns that were presented was that there is not enough guidance or the exiting guidance on the comparability criteria is not clear enough as to the situations where there is no comparable available because the uniqueness of the assets.\footnote{115} Another concern was that there is insufficient market data to do the comparability analysis and choosing the right valuation method and with not much guidance to go on this could mean that adjustments are needed which compromise the comparability and the analysis would be very subjective.\footnote{116} One concern pointed out that the neglecting of the relationship between the transactional parties. Currently the comparability analysis is focusing on the transaction itself, as seen above and the conditions for that transaction and its similarity to an uncontrolled transaction. The concern about the relationship aspect pointed out the lack of that is a distinct difference in all the transaction as there is not the same long term relationship between the enterprises in the uncontrolled transaction.\footnote{117}

Another concern regarding the lack of harmonized recommendation or clear guidance on the comparability analysis is that it gives the opportunity to different results depending on how the comparability factors are used and interpret. It does not necessarily mean that the result is wrong but it could be very expensive for businesses if the results are questioned in court.

\footnote{114} OECD TPG para.2.9.


\footnote{117} Fris, Pim, \textit{Scoping of the new OECD project on the Transfer Pricing Aspects of Intangibles Valuation issues}, 2010-11-09, NERA, \url{http://www.oecd.org/tax/transfer-pricing/46366900.pdf}. 
As an example of that is a Swedish case where a medical company had transferred intangible asset to foreign sub-company to a price that could be considered at arm’s length. The company and the Swedish Tax Agency had both brought in experts from different consultant companies to do the valuation. It is the difference in valuation between the two rapport that is interesting. Both the company and the Swedish Tax authorities had built their argumentation on comparability analysis compiled by the different tax consultants. These had been structured differently and the factors used in the analysis where different. Both reports regarded the required rate of return but the reports differed significantly due to different comparable used by the experts. It should be noticed that the company that made the analysis for the medical company, had done there analysis by using information that was handed afterwards when the transaction was already made which provided them with information that was not available before. The tax authorities questioned this information as it is easier to calculate a price if you already have the actual out coming effect on paper. The difference in the analysis ended up with a taxable income of either 682 000 000 SEK according to the Swedish Tax Agency, or 275 500 000 SEK according to the medical company’s definition of the arm’s length price. The Swedish Court of Appealed ruled in favor of the Swedish Tax Agency because the court thought that their analysis showed a more adequate arm’s length price.

This case is a typical example of what can happen if there is not enough guidance on how to approach the factors in the comparability analysis. It could end up as a huge economic burden for the companies. The question is whether this can be solved or if it is always to be an argumentative aspect of the arm’s length principle.

4.5 Chapter conclusion

The TPG apply the same rules to both tangible and intangible assets when finding a transfer price that is acceptable at arm’s length. It has been stated several times that the area of transfer pricing on intangible assets is the most difficult area, one reason is that these assets are so unique and different and has a great value for MNEs dealing with these assets so it is harder for MNEs to relate and treat these asset in an acceptable manner. The foundation in

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118 Case nr 2627-09, Kammarrätten i Göteborg, Dom meddelad 2011-06-30.

the treatment of these assets is the comparability analysis that has to be conducted in order
to set an arm’s length price. OECD has recommended a way of doing this analysis but the
procedure is not set in stone, neither are the factors that are to be analyzed and there are
even more factor when the analysis regards intangibles. By the described process it is easy to
see the effects conducting the comparability analysis has on companies, what it comes down
to is a matter of costs. As the started project by OECD has shown these current recommen-
dation has now lead to concerns where companies today do not actually know what factors
or indicators they should look at. And as the example of the Swedish case of Ferring no
harmonization might lead to great economic burdens for companies. There is also the con-
cern of not finding enough information to conduct the analysis which then can result in the
same outcome as in the Swedish case.
5 OECD project: transfer pricing on intangible assets

5.1 Chapter Introduction

Within this chapter an outline and description of the OECD project will be presented. First a small introduction to the organisation OECD and what these projects impact are on its member countries, then followed by the actual project and distinction of the problems concerning the valuation of intangible assets as well as the outcome. The chapter tries to outline why this has become a problem, what practitioners are concerned with and what the OECD is about to do to solve these problems that are effecting global trade for these assets.

5.2 The OECD

The Organization for Economic Co-operation and Development (OECD) is an organization that creates a forum for governments to work together on "the economic, social and environmental challenges of globalisation". Its mission is to "contribute to the expansion of world trade on a multilateral, non-discriminatory basis and to achieve the highest sustainable growth in member countries".

The organisation has developed the Model Tax Convention on Income and Capital (MTC) which is a guidance to eliminate the problem of double taxation that is effecting global trade by harmonizing the member countries regulation on the matter of international trade. Most tax treaties between countries are based on this convention that allocates the right to taxation between the resident and source countries, by requiring the resident country to eliminate the double taxation where there are competing taxation rights.

OECD is constantly revising the MTC and its guidelines on how to understand and apply the articles in the convention, to match the ever changing conditions of international trade between companies. The reason is that the focus of these guidelines is to address the main issues that arise within the area of transfer pricing. For the purpose of this thesis, this organizations recently issued the final reports for the work on the transfer pricing aspects on intangible assets, in order to match the current business situation of the trade with these.

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121 OECD TPG, preface7.
122 [http://www.oecd.org/about/0,3347,en_2649_33747_1_1_1_1_1,00.html](http://www.oecd.org/about/0,3347,en_2649_33747_1_1_1_1_1,00.html), 2012-03-12.
123 OECD TPG, preface 19.
kinds of assets. The OECD has realized that the current recommendations in the TPG about the trade of intangible assets is not sufficient enough and it is now effecting the effectiveness of the global trade. Because of the aim with this organization is to help global actors and governments to keep effective international trade, the OECD has started and now finished a project on this matter.

5.3 "Transfer pricing aspect on intangible assets"

5.3.1 The OECD project from start

OECDs project on intangible assets has the aim to clarify the regulations on transfer pricing on intangible assets. The project started in 2010 and was a secondary result of other OECD projects. In fact it was in relation to two other transfer pricing project, one concerning the comparability requirement and profit methods and the other concerning the transfer pricing on business restructuring, that the problems concerning intangibles was identified as a key area of concern for tax payers and governments.124

The reason for the concern was the insufficient international guidelines as described above, specifically on the matters of definition, identification and valuation of intangibles.125 In the startup of this project the project management sent an invite to interested parties to comment on questions regarding the most significant issues encountered in the practice with these assets and in transfer pricing situations, if there were any shortfalls in existing OECD guidelines, whether there were other areas needed the attention of OECD and what the interested parties believed the format of the final output of the work should be.126

The goal with the project was to focus on the most important issues on transfer pricing in order to make towards better guidance from the OECD and the aim with the project was to


125 OECD invites comments on the scoping of its future project on the Transfer Pricing Aspects of Intangibles, [Text](http://www.oecd.org/ctp/transfer-pricing/oecdinvitescommentsonthescopingofitsfutureprojectonthetransferpricingaspectsofintangibles.htm) 2015-10-06

126 ibid OECD invites comments on the scoping of its future project on the Transfer Pricing Aspects of Intangibles, [Text](http://www.oecd.org/ctp/transfer-pricing/oecdinvitescommentsonthescopingofitsfutureprojectonthetransferpricingaspectsofintangibles.htm) 2015-10-06
provide more clarity and certainty for the tax payer and governments and to create international consensus. But by taking in consideration “the need for the compliance burdens imposed on taxpayers to be reasonable and proportionate to the significance and the complexity of the transaction” when further developed the transfer pricing guidelines on the area of intangible assets.

The most important factors that this project concerns is the framework for analysis of intangible related transfer pricing issues, definitional aspects, the aspect of specific categories of transactions involving intangible assets (such as R&D, marketing intangibles etc.), identification of and characterize intangible transfers, relation to arm’s length principle and the valuation issue. Interested parties have discussed the problems concerning the three issues that the OECD initially regards as the issue with transfer pricing on intangible assets.

When the OECD was revising this area of the TPG the country leaders of the G20 countries identified other areas where the increasing globalization and its benefits also had a negative effect on the taxation of income for countries. Especially when global trade have opportunities for MNEs to minimize their tax burden by shifting profits and by that give opportunity to tax base erosion. This led to that the OECD together with the G20 countries started a project in 2013, the Base Erosion and Profit Shifting Project (hereinafter named BEPS). Within the BEPS project the intangible assets project continued.

5.3.2 Practitioners view on the project - Comments and concerns from interested parties

The project on intangible assets, is a result of practitioners increasing concerns for the handling of the increased global trade with intangible assets. Intangible assets has during the last two and a half decades become more important for businesses and their economic value. As the guidelines provide some cohesiveness in the international trade, businesses is trying to

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cope with these guidelines. However, these does not always provide practical guidance why some concerns around these guidelines has arisen.

In July 2010 the OECD requested comments on the scoping of this project. In March 2011 there was a meeting with commentators from the private sector to discuss the valuation of intangibles for transfer pricing purposes. According to the business community it was needed that the TPG minimized the conflicts that had raised between tax administrations and tax payers.\(^\text{131}\) It is recommended that MNE’s use the TPG so that the arm’s length principle is achieved in the price set in a transaction and by having clear guidance it is easier for both MNEs and tax authorities to apply it consistently.\(^\text{132}\) The aim with this meeting and the project of transfer pricing aspects on intangibles was to ”arrive at a reasonable solution” remembering that it is not an exact science as the methods based on income is made of assumptions and that ”business seeks guidance which will minimize double taxation, rather than a set of prescriptive rules.”\(^\text{133}\)

At this meeting representatives had different concerns regarding the intangible issue. Three questions that was discussed\(^\text{134}\):

*Should the OECD provide further guidance on the determination of the parameters used in valuation methods?*

*Should the OECD provide further guidance on comparability issues for intangibles?* And

*What is the relevance for transfer pricing purposes of standards developed for accounting and financial purposes?*

Based on these questions the practitioners had different concerns regarding the valuation problem. These concerns was that the guidance where not enough as they are written today and as an example of that is the existing guidelines explaining that the ”MNE groups retain


\(^{132}\) ibid.


\(^{134}\) Fris, Pim, Scoping of the new OECD project on the Transfer Pricing Aspects of Intangibles Valuation issues, 2010-11-09, NERA http://www.oecd.org/tax/transfer-pricing/46366900.pdf
the freedom to apply methods not described in these Guidelines [...] to establish prices provided those prices satisfy the arm’s length principle in accordance with these Guidelines.\textsuperscript{135} This provides an opportunity to use factors and parameters that is - in good faith - more appropriate to the particular situation which might have been done differently by a third party.

It is not only the exiting guidelines that are a problem but also that there was very little material provided by the OECD on the matter. This led to even more uncertainty and questions as MNEs has no guidance on how other MNEs do their trade or what so ever guidance on how it should be done in order to meet the arm’s length principle. By this project OECD started, this was hoped to be solved or at least clarified.

The concerns in general regards the benchmarking which is the comparability aspects. And from the material presented by the participants in the meeting, the concerns regarding the comparability aspect is the different parameters that is needed to compare a set price in a transaction within the MNE to the price set between two independent parties. The practitioners argued that the parameters is dependent on each case, but special attention were to be given to prices, costs, cash flows etc.\textsuperscript{136} The question raised was how to make sure that there would not be any risk of inconsistencies between the transactions a MNE would undertake.\textsuperscript{137} The OECD’s aim after this meeting was therefore to "develop guidance, for taxpayers and tax administrations, on how to assess the reasonableness of the parameters used and assumptions made in the application of [...]valuation methods."\textsuperscript{138}

Another concern is the OECD preferred methods and their relationship to other more general accounting and financial valuation methods. On the questions asked by the OECD was related to the existing transfer pricing methods and in relation to other financial aspects of intangible assets and whether to adopt such methods in the TPG. When establishing an arm’s length price and the use of the transfer pricing method the TPG has seen not been enough in transactions with intangible, practitioners has in fact looked into the methods of financial

\textsuperscript{135} TPG para. 2.9.


valuation to establish the arm’s length price. The concerns with using other methods such as the financial valuation methods instead of the TPG methods, was when this project was outlined, that there was no international consensus that these methods would be appropriate to define an arm’s length price. As a reflection to this concern it was raised by practitioners that the OECD should consider integrating or at least recognize other methods, such as financial and commercial, in the TPG.

5.4 Base Erosion and Profit Shifting - BEPS action plan

The TPG is a result of the article 9 in the Model Tax Convention on Income and Capital, which aims to provide guidance for MNE to comply with the arm’s length principle as seen in chapter 4 of this thesis. The MTC is a model agreement provided by the OECD to prevent double taxation of income that occurs in two tax jurisdictions. This is a result of the rapid globalization. In order not to prevent economic growth as a result of domestic tax systems, country leaders around the world agreed to provide clear and predictable international rules for such trade and by doing so give certainty for both businesses as well as tax authorities.

The MTC has been used as a guidance for a lot of bilateral double tax treaties between many countries.

As seen in this thesis, the same globalization has led to countries tax sovereignty has been affected in a negative way. The MTC only provides help on when one income is taxable in two countries under their domestic laws and which country should have more right to tax the income so that the tax payer would not be taxed twice on the same income. But as a result of a rapid globalization the tax base for countries has been hollowed as in the domestic tax rules, no account is taken to other countries tax rules (naturally). The risk is that corporations, and in this case MNEs, are forced to interact with two tax jurisdictions with the risk of double taxation, or the potential non-taxation in either jurisdictions.

140 Silberztien, Caroline, Transfer pricing aspects of intangibles, the OECD project, August 2011, Transfer Pricing International Journal, BNA. p. 5, 2015-11-12.
143 Action plan on Base Erosion and Profit Shifting, OCED, 2013, p. 9.
The result that there is no taxation, i.e. double non-taxation or less than single taxation, is the fact that the interaction between different tax rules could create this effect as well as the opportunity to explore tax rules to artificially segregate the company taxable income, by shifting profits to countries where there is low or no taxation on certain income.\textsuperscript{144}

As described under the chapter about MNEs in this thesis, the globalization has led to a different kind of trade. Nowadays the customer and the provider does not even need to be in the same country as a result of digitalization. One questions that has arisen from this operational management is “how enterprises in the digital economy add value and make their profits, and how the digital economy relates to the concept of source and residence or the characterization of income for tax purposes”\textsuperscript{145}.

The OECD state that the weaknesses in the existing multinational guidance described above is putting the international framework at risk. The risk is that some countries would lose corporate tax revenues which would belong to them according to their domestic tax rules which could lead to that they would disregard unilateral agreements taken to help avoid double taxation for companies in order to protect their tax base.\textsuperscript{146} According to the OECD this would lead to “global tax chaos”\textsuperscript{147}.

In order to prevent this tax chaos and provide further guidance to countries on the allocation of taxing rights for certain income, the G20 countries asked the OECD to provide them with an action plan preventing tax base erosion and profit shifting. The OECD aim is to provide guidance to “restore both source and residence taxation […] where cross-border income would otherwise go untaxed or would be taxed at very low rates[…]”\textsuperscript{148}, it also state that it is not aiming at changing already accepted international standards for allocation the taxation of cross-border income.\textsuperscript{149} The action plan’s main aim is to ensure that the “profits are taxed where economic activities generating the profits are performed and where value is created”\textsuperscript{150}

\textsuperscript{144} Action plan on Base Erosion and Profit Shifting, OCED, 2013, p. 10.

\textsuperscript{145} Ibid.

\textsuperscript{146} Action plan on Base Erosion and Profit Shifting, OCED, 2013, p. 10-11.

\textsuperscript{147} Ibid.

\textsuperscript{148} Action plan on Base Erosion and Profit Shifting, OCED, 2013, p. 11

\textsuperscript{149} Ibid.

\textsuperscript{150} OECD/G20 Base Erosion and Profit Shifting Project, Explanatory statement, 2014, p. 4  
as the tax on the profit from these transactions has been separated from the geographic place where the value is created.

The OECD has in their action plan looked into 15 actions to prevent BEPS and concluded that the action plan “calls for fundamental changes to the current mechanisms and the adoption for new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting.”

As a result the BEPS project will impact the MNEs transfer pricing policies, especially considering the value creation activities in the entities of the group, it will also affect the MNE’s documentation of transactions made, in order to reflect the allocation on revenue, income, taxes, economic activities etc. Also the outcome from the BEPS project will also be that the tax authorities will have the opportunity to use these rules as “valuation provision instrumental to the allocation of income to various jurisdictions or as a tool to counter aggressive income shifting strategies.”

As mentioned the project with intangible assets started in 2010 but as transactions with intangibles could lead to BEPS this has been included in the OECD BEPS project. Action 8 has the aim to “[d]evelop rules to prevent BEPS by moving intangibles among the group members.” To create these rules the OECD focused on four areas, which is as result of the previous project on the intangibles assets. The first was to establish a broad and delineated definition, the second was to ensure correct allocation of the profit associated with the intangible being transfer, with special consideration to value creation, the third was to focus on hard-to-value intangible and the fourth was to provide further guidance on cost contribution arrangements.

The final outcome of the BEPS project was presented by the OECD on October 5, 2015, where almost all rules on the intangible assets question was presented. The next sub-chapter

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152 Dr G. Cottani, *Transfer Pricing*, IBFD online transfer pricing database, 2015, p. 2.
153 Ibid.
155 Ibid.
will look further into the action 8 of the OECD combining it with the previous work of OECD on the transfer pricing aspect on intangibles.

## 5.5 Action 8 aiming at the valuation

### 5.5.1 Special considerations for intangibles,

Action 8 of the BEPS project has as seen the objectives to provide rules to prevent BEPS and by these rules provide guidance on how MNEs should convey intra-group transactions with intangible assets. The previous OECD project on transfer pricing of intangible assets has as seen the objectives to provide guidance on specific areas of concern for practitioners so to minimize conflicts between tax administrations and tax payers.

The project on intangible assets was not finished when the OECD was asked upon the G20 countries to prepare the action plan. Therefore the development of the project has taken long time as it has published several discussion draft, both before the work with the BEPS project as well as after. As can been seen in the revised discussion draft from July 2013, the previous work is related to the BEPS project and has therefore been integrated in the BEPS project.\(^\text{156}\)

One major business advantage that has occur due to the globalisation is the possibility to move profit from a transaction of intangibles from one part of the MNE to another part, for the reason to lower the tax on that transaction, creating a profit shifting. The profit is then taxed in a jurisdiction, where maybe no economic activities has been carried out to create that profit. This has created concerns which has been brought in the light with the BEPS project, which stated that the occurrence of the profit has geographically been separated from the activities creating the value the profit occurs from.\(^\text{157}\)

The aim with action 8 is to prevent such base erosion and profit shifting when intangible assets are transferred between associated enterprises. To prevent this, the focus in action 8 is to develop a broad and clear definition, an allocation parameter to distribute the profit in accordance with where the value creation occurs within the MNE, special consideration on

\(^\text{156}\) Revised Discussion Draft on Transfer pricing aspects of intangible assets, OECD, 30 June 2013, p. 1.

\(^\text{157}\) Ibid.
the ”treatment” of hard to value-intangibles and further guidance on cost contribution arrangements.\textsuperscript{158} It was also said that in order to complete the work with the BEPS project the OECD should consider the application of the arm’s length principle as well as special measures to meet the concerns raised in the BEPS project.\textsuperscript{159}

In October 2015 the final reports on the BEPS project was issued. The outcome of the project in terms of action 8, is that looking at profit and the right to that profit is no longer an absolute to the legal owner of the intangible asset. Instead, the profit should be allocate to the parts of an MNE that contributes to the value due to performing functions to create the value of the intangible asset, that control economically significant risks as well as contribute assets to create the intangible.\textsuperscript{160} By looking at how the profits should be allocated, this will affect the valuation of the price set in intra-group transaction, especially considering the comparability of such transactions. Also, the action 8 provides guidance on valuation methods that will allocate correct profits (or part of the same) to the group members that provides the most important economic activities to create the intangible being transferred.\textsuperscript{161}

It should also be pointed out before looking into the valuation of intangible assets that all parts of the appropriate guidance on the valuation methods for transactions intangible assets is not yet provided by the OECD, this is specially considered for valuation of hard to value-intangibles. The objective is to provide further guidance in early 2017.

5.5.2 Applying arm’s length principle within Action 8.

The arm’s length principle is a cornerstone in the transfer pricing area and the strive for MNEs is to uphold this principle when conducting intra-group trade of intangible assets.\textsuperscript{162} In the final BEPS report it is stated that the arm’s length conditions should be able to be determined once the transaction has been identified as well as the intangibles included in that transaction, and when the legal owner as well as those entities who contributed to the value

\textsuperscript{158} Guidance on transfer pricing aspects on intangibles, OECD, 2014, p. 9.

\textsuperscript{159} Guidance on transfer pricing aspects on intangibles, OECD, 2014, p. 11.


of the intangible, has been identified.\textsuperscript{163} Once this is done the TPG chapter 1 to 3 should be used to determine the arm’s length conditions for intangibles as well.\textsuperscript{164} These chapter provides the guidance on how to set an arm’s length price, taking in consideration both the comparability aspect (described in chapter 3) as well as the applicable valuation method (described in chapter 5). As these chapter has historically (up until the last BEPS reports) created uncertainties due to the special characteristics of intangible assets, action 8 objectives is to provide supplemental guidance for applying chapter 1 to 3 in the TPG to determine the arm’s length conditions.\textsuperscript{165}

5.5.3 Comparability analysis according to action 8

One initial concern was that how to compare and by that set an arm’s length price on a transaction involving intangible assets between two associated enterprises as the guidance in chapter two of the TPG was not always applicable to transactions with intangible assets, as described in chapter 6 of the TPG.\textsuperscript{166}

Action 8 has stated that the nine step process (in Chapter three of the TPG (see chapter 4.4.2 in this thesis) should also be used for transactions involving intangibles with special considerations to the outcome of the BEPS report "Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports".\textsuperscript{167} In this report the comparability analysis has been further developed for MNEs so a correct arm’s length price could be determined.

Firstly the OECD states that when conducting the process in TPG chapter 1 to 3 (guidelines for the arm’s length principle, the transfer pricing methods and the comparability analysis), and especially for the application of the comparability analysis, the transactions between associated enterprises must be evaluated from the perspective of each entity involved in the transaction and based on most realistically available options for that entity. This means that MNEs need to evaluate all the options as if the entities preforming the transaction in the MNE was not associated and whether or not they would perform the transaction in that


\textsuperscript{165} Guidance on transfer pricing aspects on intangibles, OECD, 2014, p. 11, para. 6.105.

\textsuperscript{166} TPG p. 195, para. 6.13.

case. As OECD state it, that "the specific business circumstances of one of the parties should not be used to dictate an outcome contrary to the realistically available options of the other party." The BEPS report on Action 8 continues with stating that in most case it is that the price set between MNEs, due to the business relation between these enterprises, is not always based on realistically options between third parties, and that the price might therefore not be recognized by tax authorities as an acceptable transfer price, meaning that the set price could be adjusted or recalculated based on other realistically options. What needs to be kept in mind in this situation is that the tax authorities might do an audit or review such transactions six or seven years after they are performed. Therefore the OECD highlights the importance of evaluating all relevant facts and circumstances in each case to correctly define the current transaction of intangible performed.

Secondly, the BEPS report on action 8 address the comparability factors in chapter 2 and provide further guidelines on how to make a comparability analysis for intangible assets. As intangible assets has unique characteristics which potentially have diversity in outcome both in generating profit and further benefits, it is important to consider these characteristics when preforming the comparability analysis. In the BEPS report the OECD has listed some of these special characteristics intangibles has as guidance but points out that it is not limited to these factors and practitioners should consider other factors that could have effect on the comparability in the transaction performed.

The list includes characteristics such as:


170 ibid para. 6.114 and OECD TPG p. 51, para. 1.65.


• Exclusivity – if the rights in the intangible being transferred, exclusive or not will have impact on the comparability of that transaction. For example patents which gives an exclusive right to use an invention for X amount of years which limit the competition for those years.

• Extent and duration of legal protection – the length of the protection will have an effect on the comparability as this decide how long the owner of the intangible can prevent competitors to enter the market. As an example, two otherwise comparable patents does not have equivalent value if the duration is not the same.

• Geographic scope – the size of the geographic area that the intangible is effective within does have an impact on the comparability of the intangible.

• Useful life – how long will the intangible be useful with consideration to changes in technology, development and adaptation.

• Stage of development - is the intangible under development? And in what stage are the intangible when valuating it? Will further development effect the commercial value? According to the OECD these are important factor to consider when conducting the comparability aspects for intangibles. As an example mentioned in the BEPS report these are important within the pharmaceutical industry.

• Rights to enhancements, revision and updates – if the grant of an intangible or rights to an intangible also includes the access to enhancements, revision and updates, this will impact the comparability of that intangible.

• Expectation of future benefits - the BEPS reports states that the factors that MNE estimates the future benefits from an intangible asset, should be taken into consideration for the comparability of such transaction.

Also action 8 in the BEPS report develops the aspect of risk in chapter 2 of the TPG, looking into different types of risk which should be considered when comparing transactions involving intangibles. The risks that should be considered are ”the risks related to the likelihood of obtaining future economic benefits from the transferred intangible”175 as well as the risk allocation between the enterprises involved in the transferred intangible.176 The examples


176 Ibid.
given in action 8 is risk related to future development and success for such development, future competition within the market, infringement, product liability that the intangible are protecting, as well as other potential risks that could occur related to the future use of the intangible.\footnote{OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, \url{http://dx.doi.org/10.1787/9789264241244-en}, p. 96-97, para. 6.128, as well as the points in that paragraph.}

In the TPG it is stated that sometimes there is a need to adjust the comparable factors to provide a more reliable and accurate arm’s length price and such adjustment is only to be considered if the adjustment would achieve that.\footnote{OECD TPG para 3.47 and 3.50.} Chapter 3 of the TPG\footnote{OECD TPG para 3.51.} states that comparability adjustments are only appropriate for differences that will have a material effect on the comparison.\footnote{OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, \url{http://dx.doi.org/10.1787/9789264241244-en}, p. 97, para. 6.129.} Chapter 3 on this aspect applies also to the comparability analysis for transactions involving intangibles according to the BEPS report on intangibles.\footnote{Ibid.} But with the economic consequences intangibles could have due to their differences, it is stated that the comparable factors could be difficult to adjust to achieve a more reliable result. Therefore, if the comparable factor could not be adjusted to achieve this, it is recommended to use a different transfer pricing method to set an arm’s length price, which is less dependent on comparable factors.\footnote{OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, \url{http://dx.doi.org/10.1787/9789264241244-en}, p. 97, para. 6.130.}

Another comparability factor that has been looked upon is when intangibles are compared to each other based on information from commercial databases and other publicly available information. The question raised in the BEPS report concerns whether the information gathered from these databases is sufficiently detailed to make an evaluation of the specific features that the intangible being compared have, as these special features could have an important impact in the comparability analysis.\footnote{KPMG Tax News, 2015-10-12, OEDC (BEPS 8-10): Om internprissättning och närliggande frågor, \url{http://www.kpmg.com/SE/sv/kunskap-utbildning/nyheter-publikationer/nyhetsbrev/taxnews/taxnews-2015/Sidor/TaxNews-55-2015-sv.aspx}, 2015-11-17.} Instead it it’s recommended to use the valuation methods to set the correct price.\footnote{KPMG Tax News, 2015-10-12, OEDC (BEPS 8-10): Om internprissättning och närliggande frågor, \url{http://www.kpmg.com/SE/sv/kunskap-utbildning/nyheter-publikationer/nyhetsbrev/taxnews/taxnews-2015/Sidor/TaxNews-55-2015-sv.aspx}, 2015-11-17.}
5.5.4 Choosing the right transfer pricing valuation method

Action 8 of the BEPS report states that the TPG chapter 2 on choosing the most appropriate transfer pricing method should also apply to transactions with intangibles, but some special 
"attention should be given to (i) the nature of the relevant intangibles, (ii) the difficulty of identifying comparable uncontrolled transactions and intangibles in many, if not most, cases, and (iii) the difficulty of applying certain of the transfer pricing methods described in Chapter II in cases involving the transfer of intangibles." 184

In deciding on which method is the most appropriate to use when deciding an arm’s length price, the report states that it is the economic consequences of the transaction that should form the basis for such decision. 185 To evaluate the economic consequences of the transaction involving intangibles, the functions creating the value has to be evaluated and analyzed. 186 It should not be assumed that the profit (after a limited return to function performing entities) from the transaction should only be allocated to the owner, but instead more focus has been given to the enterprises that perform the functions creating the value, i.e. a functionality analysis has to be performed. This analysis should provide a clear understanding of the MNE’s global business process and how the transferred intangible interact with functions, assets and risk of the MNEs global business. 187 The functionality analysis should identify all factors and "economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions." 188 These factors has contributed to the value of the intangible, which could include risks borne, specific market characteristics, business strategies, locations as well as all relevant material factors contributing to the value creation, i.e. not only the intangibles and routine functions. 189 The functionality analysis has been given a lot of room in the BEPS report and specifically within

187 Ibid.
188 Ibid.
action 8-10. Due to the objective of the BEPS project the functionality analysis will provide better understanding where the actual value is created and ownership does not in itself constitute the right to the profit. Therefore the analysis reviews what the different enterprises within the MNE actually do and what they contribute with in order to create the value of the intangible.\(^{190}\) The comparability analysis including the functionality analysis, could there for be reliable as a transfer pricing method to determine an arm’s length price where there is reliable information to be compared.\(^{191}\)

The question raised from the practitioners were further guidance on the application of the five established transfer pricing methods in the TPG chapter 2 as these were hard to apply on intangibles due to the unique characteristics. As a result of this uniqueness, it is difficult to find a comparable uncontrolled transaction, why further guidance is given in the BEPS report. The OECD states that where no comparable are available the arm’s length price should be determined using ”another method to determine the price that uncontrolled parties would have agreed under comparable circumstances[,]”\(^{192}\) and are listing the factors that should be considered to determine the correct arm’s length price.\(^{193}\) It is also explained that transactions between enterprises within the MNE is not, and does not need to be, structured like transactions between independent enterprises, but” the effect of those structures on prices and other conditions that would have been agreed between uncontrolled parties under comparable circumstances should be taken into account in evaluating the profits that would have accrued to each of the parties at arm’s length.”\(^{194}\).

The OECD has provided guidance on the appropriate transfer pricing method in the situations where there is comparable factors in both the controlled and uncontrolled transaction as well as when there is no comparable factors. The CUP method is said to be the most


\(^{193}\) Ibid, please see whole list in para. 6.139.

appropriate method where there is a reliable comparable uncontrolled transaction and information of such is available. 195 The OECD states that the guidance in chapter 1 section D.1 should be considered, this is a cross reference to the comparability analysis stating that when using CUP it is important to acknowledge the differences between the controlled transaction of the intangible and the uncontrolled transaction used as a comparable and the potential adjustment needed.196 Where there is no reliable comparable uncontrolled transaction it is said that the profit split method is most reliable. If the profit split method is reliable or not, lies within the available information regarding ”combined profits, appropriately allocable expenses, and the reliability of factors used to divide combined income […]”197. The profit split method is said to work best for transactions involving sale of full rights to the intangibles as well as partially developed intangibles.198 When applying the profit split method the functionality analysis should be performed, considering the functions performed, risks assumed and assets used. For partially developed intangibles special attention should be given to potential value of the contribution to the development of this intangible, both before and after the transaction, which is based on projections of cash flows and expected benefits in the future.199 The OECD continues with examples and also describing risk with using the profit split method. The guidelines on this valuation method is not yet finalized as practitioners has under the development of the BEPS project raised concerns that this method is not straightforward to apply and further clarification and strengthening of the guidelines on the profit split method is needed.200 The OECD states the further guidance on this method need to consider the changes in transfer pricing guidelines due to the BEPS report (all actions) and as when the action 8-10 report was issued not all actions were finalized, the work on guidance for the

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196 Ibid.


198 Ibid, p 101, para 149-150.


The TPG opens up to use other valuation techniques than the established methods stated in the TPG as well. It is stated that the most appropriate method to be used is the one which sets the most reliable arm’s length price. If the five established method does not set the most reliable price other methods can be used. When using other valuation methods, these has to be in line with the arm’s length principle. In action 8 and for the valuation of intangibles it is not stated which other methods could be used, but it is said that when using other methods, it is essential that the underlying assumptions and motivations to use these is considered. As an example stated in the report, accounting method to set an arm’s length price could sometimes be difficult as the assumptions in setting a price for accounting purposes could be too conservative when reflected in the company report. This conservatism could then have an negative effect for setting a price for transfer pricing purposes as definitions could be to narrow. Due to this OECD state that the valuation method should be used cautiously.

The report does not give any examples or lists any other valuation method that could be used for transfer pricing methods instead of the five established. This is intentional as it is not the OECDs place to approve or reject the methods used. However, the report does state that valuation methods which estimates the discounted value of projected future cash flows are useful methods as these defines ”realistic and reliable financial projections, growth rates, discount rates, the useful life of intangibles, and the tax effects of the transaction.” Though it is said that valuation methods based on projected cash flows there are some risks with this. These risks are based on the fact that the estimated value could be very affected by small

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203 Ibid. para 6.154.


205 Ibid.


changes in the assumptions creating large differences in the value for the first assumption to the other.\textsuperscript{208} Other concerns identified by the OECD that should be considered is\textsuperscript{209};

- **Accuracy of financial projections** – the risk lies within the accuracy being contingent with market development and that is both unknown and unknowable when the valuation of the intangible is estimated. Therefore the tax payers and tax administrative must carefully examine the underlying assumptions of the future profits and expenses.

- **Assumptions of growth rates** – Projections of future cash flows are usually based on the current growth rate and the addition of a percentage of this rate. The risks with this is that this result in a projection of a steady growth which is not always the case.

- **Discount rates** – considers the time factor and risks of anticipated cash flows. As intangible assets is one of the most risky components in a business, the risk identified by the OECD is that there are no single measure of discount rate that is appropriate for all instances when using this for transfer pricing purposes. Therefore when determining discount rates for these purposes the facts on circumstances, especially considering risks, should be taken into account.

- **Useful life of intangibles and terminal values** – the valuation methods for projection of cash flows are based on the exploitation of an intangible during its life time. The risk identified is the determination of lifetime as this could be affected by the nature and duration of legal protection, if the intangible continuous to deliver value after the legal protection has expired etc.

- **Assumptions regarding taxes** – the projection of cash flows will also have an effect on the projection of future income taxes, why these has to be evaluated and quantified.

The report state that when using other valuation methods than the acknowledged five, and especially considering the above mentioned risk, it is very important to document the assumptions made, and why a specific valuation method is used and if changes are made during a project. Especially since it is also suggested that tax administrative request explanations of


the assumptions made in these valuation methods.\textsuperscript{210} The result of this is that using other valuation methods than the five acknowledged by the OECD is a highly argumentative approach and is dependent on interpretations of these arguments.

\textbf{5.5.5 Practitioners view on the final BEPS action 8}

The BEPS action 8-10 with special consideration to intangible assets will replace the TPG Chapter six ”Special considerations”. It is stated that as the above described changes is only a clarification of the TPG in chapter one to three as well as chapter six these new guidelines are effective immediately and will also apply backwards in time.\textsuperscript{211}

One outcome that has been seen with this project is that the OECD is looking more and more into where the value creation of the intangibles is within a MNE group. It is said that the revenue of a transferred intangible asset is to be allocated based on in which entity the different aspects of the value in the intangible is created. It is no longer the owner that is automatically entitled to the revenue but in fact several function-preforming entities.\textsuperscript{212}

In general the outcome of the Action 8 report is that the OECD opens up for a more informative approach in the guidelines, with the perspective of giving the tax authorities this information.\textsuperscript{213} One aspect where the tax authorities already have shown interest in, is the valuation of the transactions of intangibles. Due to the new approaches in this aspect, this interest is assumed to increase.\textsuperscript{214}

One of the concerns is the risk allocation that should be part of the comparability aspect. Practitioners have raised concerns that such a risk allocation set out in the report is ”too


\textsuperscript{211} Skatteverket, Seminarium om BEPS, from 1/12 – 2015, video at https://vimeo.com/147443629, at minute 27 (watched 2015-12-03).


\textsuperscript{213} Ibid.

ambiguous and onerous to be manageable”\textsuperscript{215}, demanding much more details in both the risk allocation as well as the valuation guidelines which makes it harder for MNEs to comply with. This level of detail creates many more analyses and aspects to consider within the transfer pricing documentation. The concern is that even with the best intention it might be very difficult for MNEs to comply with the new guidelines in this aspect, and if failing could increase the risk of double taxation, tax disputes, and re-characterization of the transaction of the intangible. Also, the tax authorities are also provided with many more means to challenge and scrutiny the transfer pricing policies that the MNE has set up in order to follow the new guidelines. Further to the comparability aspect, concerns has been raised that the report does not provide practitioners with sufficient information on solving the difficulty with finding comparable transactions, especially considering comparable risk factors.\textsuperscript{216}

Also, as the OECD welcome the use of other valuation methods than the five established as long as these are in line with the arm’s length principle. The opportunity to such valuation methods is criticized by many practitioners as this seems to be a step away from the arm’s length principle.\textsuperscript{217} Instead, other valuation methods should be used as a last resort when established methods does not give a comparable price at arm’s length.\textsuperscript{218} Also a concern with using other valuation methods is the fact that they are not harmonized such as the five established methods. Using these other measure would then cause uncertainty among the tax payers. To avoid this risk, it was said that ”there must be a clear and consistently applied set of criteria for their application” \textsuperscript{219}, both for tax payers as well as all tax administrations so no increase in tax disputes or risks if double taxation would occur.\textsuperscript{220}

\textsuperscript{215} Confederation of Swedish Enterprises (Svenskt Näringsliv) Comments to the OECD Discussion Draft, Comments Received on Public Discussion draft, BEPS Actions 8, 9 and 10: Revisions to Chapter 1 of the Transfer Pricing Guidelines (Including Risk, Recharacterisation and Special Measures), part 1, p. 229.

\textsuperscript{216} Ibid.

\textsuperscript{217} PWC’s Comments to the OECD Discussion Draft, Comments Received on Public Discussion draft, BEPS Actions 8, 9 and 10: Revisions to Chapter 1 of the Transfer Pricing Guidelines (Including Risk, Recharacterisation and Special Measures), part 2, p. 669-670.

\textsuperscript{218} Association of British Insurers, ABI, Comments to the OECD Discussion Draft, Comments Received on Public Discussion draft, BEPS Actions 8, 9 and 10: Revisions to Chapter 1 of the Transfer Pricing Guidelines (Including Risk, Recharacterisation and Special Measures), part 1, p. 7.

\textsuperscript{219} Confederation of Swedish Enterprises (Svenskt Näringsliv) Comments to the OECD Discussion Draft, Comments Received on Public Discussion draft, BEPS Actions 8, 9 and 10: Revisions to Chapter 1 of the Transfer Pricing Guidelines (Including Risk, Recharacterisation and Special Measures), part 1, p. 240.

\textsuperscript{220} Ibid.
5.6 Chapter conclusion

The transfer pricing of intangibles was first lifted as a problem when the TPG was reviewed in 2010. The OECD lifted this as one of the most problematic area of transfer pricing and started a project to understand the practical difficulties MNEs had to comply with the TPG on transactions with intangibles. The aim was to provide clear and cohesive guidance as this had been requested by practitioners, and without adding too much of a compliance burden on them.

During this project the G20 courtiers recognized another problem with intra-group trade, the opportunity to tax base erosion due to profit shifting and wanted the OECD to set the guidelines to prevent BEPS and the risk of double-non taxation of income that could occur to the uncertainties in the regulations. The BEPS project set out 15 actions where BEPS situations had occurred.

Action 8 concentrated on preventing BEPS where intangible assets were transferred between associated enterprises, by looking into the arm’s length principle. One addition to the arm’s length principle and to set this price, the OECD defined that in order to set an arm’s length price and making sure that the revenues are tax correctly, focus should not only be on the owner of the intangible but as well as on parties contributing to the value of the intangible being sold. These parties had to be identified before the comparability analysis could be performed.

Also, the comparability analysis has been scrutinized in the BEPS action 8. The comparability analysis has been further described as guidance on from which perspective the analysis should take, from both parties in the transaction. Also further guidance has been given on specific factors that should be looked at especially for intangibles. A risk allocation requirement is also added to the comparability aspect.

Valuation methods is also discussed and clarified in the BEPS report. The OECD makes a clear distinction on which method to use on certain situations, CUP should be used when there are comparable transactions and Profit split is the most appropriate method where there are no comparable transactions. Concerns are lifted to this approach as the profit split method is difficult to apply and most intangible assets transactions does not have comparables. The OECD has continued the work to develop guidelines on this matter further.
Other valuation method outside the TPG is also free to use for MNEs but caution should be taken in these matters. The reason is the lack of cohesiveness for these rules. However, most preferred methods outside the TPG is cash flow methods. Both when conducting the comparability analysis as well as when other valuation methods is used it is very important to document the reasons and explanations of how.

Practitioners has reacted to the informative approach that has been set out in the BEPS project. Many of the added guidance requires documentation, especially when using other methods than the established TPG methods. The opportunity to use other methods has been described as a step away from the arm’s length principle and this should only be used with caution.

Next chapter will look into the effects the BEPS report will have for MNEs.
6 Analysis

6.1 Chapter introduction
As the first initiative to the project on transfer pricing on intangible assets was raised by the practitioners asking for further guidance on chapter 6 of the TPG the question is if the BEPS work has provided that guidance that was needed and to what cost for the MNEs. The first part of this analysis will focus on the actual OECD project on intangibles and the integration in the BEPS action plan. The next part will focus on the guidance on the compatibility issues previous to the project and to the outcome. The third part of the analysis will focus on the valuation methods and the effect on the transfer pricing on intangibles. And the last chapter will summarize the potential problems or concerns with the outcome of the OECDs project on intangible assets.

6.2 From OCED Project on intangibles to BEPS action 8
The OECD project on intangibles was one outcome of the TPG revision in 2010, and the objective were to provide guidance to practitioners on how to apply transfer pricing rules to their ”new” trade of intangible assets among their MNE group, as this had become a problem and there were indications of distortion of taxes. The questions were raised to the practitioners asking them (both MNEs, business commentators as well as tax authorities.) what was needed in the guidelines. As seen in this thesis, the most problematic area for the practitioners was to understand and comply with the guidelines on intangible assets as they were stated at that time. Especially considering the aim to reach an arm’s length price by using the comparability analysis and the valuation methods at hand. The lack of clarity and certainty created risks of diversified treatment of transactions with intangibles, and as well as both double taxation as well as more favorable tax planning due to the setup of the business. The set out in initial project was to provide better understanding of the transfer pricing regulations on transfer pricing with the aim of finding international consensus, and when doing so not adding to much of an administrative burden for the tax payer.

The reason for the project and why concerns were raised from MNEs is the business objectives for intra-group transactions especially with intangible assets. Trading within the group itself has economic benefits for companies. Being able to trade with intangible asset between group members have also had an enormous effect on global trade. This is so as MNEs have had the chance to lower their costs by having assets in different countries. This, however, led to a situation of negative tax planning, intentional or not, why MNEs asked for guidance.
on how to apply the transfer pricing regulations to transactions with intangible assets. Especially considering the valuation of the intangible assets as well as the comparability analysis to set an arm’s length price.

During this project, the effects of intra-group trade with intangibles is seen within the countries where the MNEs operates, and the G20 countries identifies risk with tax base erosions and the profit shifting in these cases. Basically the same weakness identified by the MNEs was also identified by the G20 countries, identifying risks of countries loosing tax revenues. Therefore they asked the OECD for guidance to restore source and resident taxation to minimize the risk of less than zero or no taxation on cross border income, aiming at taxation where the value is created.

The interesting part with the intangible assets project integration into the BEPS-project, is the shift of perspective. It seems to move away from guiding the MNEs to a fair practice of setting arm’s length prices on intra-group transactions which is in line with transactions between independent parties, towards guiding tax administrations to find negative tax planning. The BEPS-report action 8 is outlined so that the tax administrations will have more insight in the business operations of MNEs as the new regulations requires much more documentation on how MNEs have set an arm’s length price. It seems that the objective with clarity and cohesiveness and the consideration of the compliance burden imposed has been forgotten in the BEPS report. The compliance burden for taxpayers is supposed "be reasonable and proportionate to the significance and the complexity of the transaction"\textsuperscript{221}, and even though transactions with intangible assets are completed the question is whether the compliance burden imposed in BEPS-report truly are proportionate and reasonable. Especially considering that the MNEs asked for help to be compliant to the set regulations in the TPG and with the BEPS-reports aim to hinder MNEs to use the guidelines to distort taxation.

It seems that when the effect of regulations and preventing double taxation on income, became more favorable for the MNEs, i.e. when the global trade no longer enhanced the competition in other countries creating tax revenues but instead leaves the MNEs with the upper hand, the G20 countries demanded a change. The background in BEPS to protect state sovereignty and revenues is therefore political. When something like this is becoming political it is hard to motivate the MNEs to further help countries where development is needed, by

\textsuperscript{221} See above section 5.3, page 36 in this thesis.
establishing business there. Could the set up in BEPS in any hand slow down the globalization? Maybe.

6.3 Setting an arm’s length price
6.3.1 Enough guidance on comparability?
It has been pointed out that the arm’s length principle is the cornerstone of transfer pricing, setting a price that would be reasonable comparable between independent parties. When a transfer of intangible asset is priced in accordance with the arm’s length principle it is said to be comparable to a price set between two independent parties. When dealing with intangible assets the difficult part is to find a comparable uncontrolled transaction. This was one of the issues raised in the 2010 objectives on how to compare intangible assets as not much data is available to compare to. Due to this factor finding comparable data was even from the beginning a very daunting task for MNEs. The five comparability factors described in the TPG have been dismissed by practitioners as not providing enough guidance for comparability of intangibles due to their uniqueness. Due to these concerns OECD have in the BEPS report on intangible assets provided further guidance on these comparability factors as well as adding other that should be part of the comparability aspect.

One aspect that was first lifted in the BEPS project was the aim to allocate the profit from the transaction to the part of the MNEs that performed functions to create the value of the intangible, as well as contributed with assets and responsibility for risk assumed with the transaction. This approach has affected the comparability analyses, by further developing the functionality analysis, stating that the arm’s length conditions are once determined when the legal owner as well as those entities who contributed to the value of the intangible, has been identified. For MNEs this means that in order to set an arm’s length price, the enterprises contributions for function performed, assets used or risk taken, needs to be evaluated in each transaction involving an intangible asset. This could be very difficult depending on if the asset is under development or not, and also due to the structure of the MNE. Even if, from a tax perspective, taxation based on value creation is a good idea, there might be risks involved. There might be risk for double taxation if tax authorities in two countries argues that the profit allocation and functionality analysis is done wrong. This would in that case move away from the objective of the MTC, limit the risk of double taxation, where the TPG is based upon.
Another aspect in comparability aspect in the BEPS report is the approach that the comparability analysis is that it should be considered from both parties in the transaction. This means that all the business reasons for a transaction should be evaluated as the parties was not related and if either one would in that case do the transaction. Preforming such a comparability analysis based on both angles is technically not wrong as this would be the case in a situation between unrelated parties, but MNEs have the opportunity not to act as independent parties as they are not. They have the opportunities to trade differently due to the business relations of MNE. According to the OECD, this is causing unrealistic options which is not found in relations between independent parties and therefore the set controlled price might not be recognized by tax authorities as an acceptable transfer price, meaning that the set price could be adjusted or recalculated based on other realistically options. The predictability for MNEs to set an approved arm’s length price in these cases is almost non-existent.

When it comes to the actual comparability factors the OECD has tried to provide guidance on factors that should be considered especially for comparability on intangibles. The list is only examples of factors to be considered when making a comparability analyses and it strongly pointed out that this list is not exhaustive and other factors could be considered. This creates concerns that different approaches might be used even for similar transactions within the same MNE. Even if the list is better than nothing it is still not cohesive nor clarified enough to establish confidence in the analysis.

Also mentionable as a problem area with the comparability analysis is the risk allocation. Practitioners has stated that the risk allocation in the comparability analysis is too much for companies to handle as this involves finding comparable risk management between independent parties. The detailing of such documentation both in the transaction in the MNE as well as finding comparable is said to create only more analysis that even with best intentions could be difficult to comply with. One can only agree that this is very ambitious from the OECD to require this, but there is an opening that with the development of the guidelines on the profit split method will ease this part.

The scary part of the new guidance on the comparability analysis is the small changes in each part of the analysis. If the tax authorities question one part of the comparability aspects and is right in its questions, it will have a huge effect on the rest of the comparability analysis, function analysis etc. Usually the tax administrations does not argue the underlying reasons
for a set price at the time of the transaction itself, but maybe years after. This creates a responsibility on the documentation of the underlying reasons and arguments for an intangible asset transaction between dependent parties.

The questions and requests for clarified and cohesive guidance on the comparability aspect with special consideration to comparability factors from the initial OECD projects could be seen as fulfilled, specifically the clarifications of the guidance on intangible assets both in fact that the set up in the BEPS report will replace the TPG chapter 6 and by examples. Though, even this argumentation could be questioned as to the shift the project took when the BEPS aspect took over, MNEs and other practitioners could not have had a chance to foresee the burdensome outcome when asking for clarification on the regulations in the TPG. The question is if the requested cohesiveness is met yet as there is still issues with the no harmonized list of factors creating uncertainty on correct application of the transfer pricing regulations. Also due to the additional clarifications on risk allocation, functionality analysis, it should be pointed out that the administrative burden for MNEs has increased in a manner not expected when this project was set out. In this case it should be questioned if the extra administrative burden in the comparability analysis is reasonable and proportionate.

6.3.2 **Enough guidance on valuation methods?**

Other questions that was raised in 2011 concerned the valuation methods in the TPG. These questions were if further guidance was needed on the determination of the parameters used in valuation methods and if valuation methods for accounting and finance purposes could be relevant for transfer pricing purposes. The reason for these questions were the opportunity set out in the guidelines that if other valuation methods than the recognized in the TPG, would establish a more satisfactory arm’s length price, this method should be used. The opportunity to use other valuation methods had already been done by practitioners but the concerns when doing so was that there is no international consensus for these valuation methods. Also the question whether this was in line with the arm’s length principle was lifted and practitioners asked the OECD to look to integrating such financial and/or accounting method in the TPG.

The BEPS project do address the concerns with other valuation methods than the five recognized. But in order to choose a valuation method, the choice should be based on the economic circumstance of the transaction. The BEPS report states that in order to evaluate those circumstances, a functionality analysis needs to be taken into account, meaning that in
each transaction the functions performed, assets used and risked assumed needs to be evaluated. The aim is to provide a clear understanding of the MNEs global business process. In order to provide such clear understanding to set a valuation method on the transactions, the documentation requirement would not be imaginable. Would it be reasonable to? Would it be proportionate towards the complexity of the transaction? Probably not, but the aim with such an analysis is to understand where the value is created which may make it easier to find comparable transactions and using the most appropriate valuation methods.

The guidelines has been further developed in terms of which valuation method that is to be used. The OECD has clarified that in transactions were comparable are found the CUP method should be used especially considering the functionality analysis. Where there are no comparable to the transaction of the intangible it get trickier. The BEPS report action 8 states that in these cases the profit split method should be used. It is defined when and to which kind of transactions of intangible assets this methods works best but it is also stated that it is only reliable where there is enough information available. When is that and what information does this ”enough” mean? Again, this creates uncertainty for MNEs to comply and risk is that the price set by using the profit split method will be adjusted afterwards, creating more unforeseen taxes. Along the way of this project this has been pointed out and the guidelines has been criticized that they are not straight forward to apply this method. Therefore the guidance on the profit split method is still under scrutiny by the OECD and it will be very interesting to see if the OECD manage to make this clear and easy to apply on transactions of intangibles.

The most interesting question raised in the project of intangible assets, for valuation method purposes, is the opening to use other valuation methods than the TPG recognized. This has been said to fall outside the arm’s length principle even though the TPG states that the used method should be in line with the arm’s length principle. The question were if other valuation methods should be recognized in the TPG and practitioners opened up for widen the TPG valuation methods to also include other methods. In the BEPS report there is not much practical guidance to which methods could be used. The intention to not provide a list of valuation method is intentional according to the OECD, and the reason is that it is not the OECDs place to approve or reject methods use. This confirms the concern that valuation methods based on accounting or financial aspects are non-cohesive and the OECD seems not willing to set guidelines to hinder that diversity. However, the OECD does identify valuation methods that are based on projected future cash flows as a good way to start but there
are risks with using these methods. One being that it is very influenced by fluctuations and changes which have impact on the end result. One reason for leaving the guidelines fairly untouched could be that due to the special considerations intangible assets means, it is difficult to make them fit within the frame of the established valuation methods, why there must be some freedom to value intangible assets in line with the price set by independent parties.

Due to the opportunity to use other valuation methods, MNEs have more freedom in setting a price in intragroup transaction. By using other valuation methods than the TPG methods, MNEs does not have the same comparability requirement, as when using the ones in the TPG. Though this freedom comes with a price, as choosing to use other valuation methods that does not have any anchoring in the BEPS report action 8, will be argumentative and speculative, creating more administrative burden. It will also leave MNEs uncertain on when to use other valuation and when not to.

6.4 Outcome of the OECD projects

Looking at the different projects and there individual aim it is a clear difference in perspective even though the though behind both projects is to provide guidance on the intra-group trade with intangible assets. The initial OECD project aimed to clarify the regulations so that MNEs could comply to this without risking an accidental tax distortion due to insufficient guidance. The BEPS project aim was to prevent MNEs to use insufficient guidance, for tax base erosions and shifting profits to low taxation-countries. Even if the objective in both projects, i.e. clarifying the TPG on the aspect of intangible assets and preventing BEPS could be considered to be met, the outcome of the BEPS report versus the aim in the intangible assets-project is questionable. There is lack in the cohesiveness on the application of other valuation methods, there is much more administrative work added on the MNEs which was not intended from the beginning. The increase in the administrative work, both when it comes to the comparability aspect as well as choosing the valuation methods, regardless if it is an recognized TPG method or other, should not be considered reasonable of proportionate to the complexity of the intangible assets transactions, in general. The reason is that this is not reasonable or proportionate is that the extra administrative burden when applying these guidelines, might not be enough. As seen in this thesis, if the Tax Agency does not approve of an argument within a TP documentation for a set value, this could change the whole outcome of the transaction. Tax should be transparent, MNE should be able to foresee at least in most cases, what the outcome would be - if done this, so this. By neglecting
the objective, the MNEs are left in the favor of the tax authorities. It seems that the OECD has forgotten this when dealing with the prevention of BEPS.

Action 8 on intangibles in the final BEPS report will replace the chapter six in the TPG and as it is only a clarification of the previous chapter six it will be effective immediately and for previous years. For MNEs this will probably create another huge administrative burden as all the transactions previously made needs to be scrutinized towards the new guidance. This could be very difficult as well, especially towards identifying underlying reasons to the value set a number of years later.

The outcome of the BEPS project is the increased requirements on MNEs as well as the unpredictability in using the guidelines. As small changes in circumstances between the circumstances prior to the transaction and until the tax authorities questions the transaction can have a such an effect on the predictability for MNEs, it could truly throw them of both in terms of taxes paid, as well as to paying more taxes and other tax jurisdictions becoming involved. The unpredictability also shines through even if the MNE is acting in good faith and by specially trying to meet the new requirements. As seen in the Swedish case, Ferring, the problem was basically argumentative as the Swedish Tax Agency’s approach to that price seemed more legit than the pharmaceutical company’s. Both sides argued for their approach and the outcome of that case was a huge unforeseen (at the time of transaction) tax bill for the company.

In this aspect it should not be forgotten that MNEs asked for more guidance for trading on equal terms, even though there are differences of business structure, between both controlled as well as uncontrolled transactions with intangibles. The aim for many MNEs is not to distort taxation but to increase the revenues within the frame of the laws and regulations there are. But due to this administrative burden and uncertainty that the tax authorities might question the approaches taken by MNEs, risking both fines and reputation, it seems like the BEPS report only made it more difficult for MNEs who is trying to be compliant.
7 Conclusion

The purpose of this thesis was to describe, analyze and discuss the problems of valuating intra-group transactions with intangible assets within the OECD project of BEPS. Valuation of intangible assets is made through the use of valuation methods as well as the comparability analysis within the TPG. The thesis has pointed out the difficulties with these rules and explained the projects the OECD has work on for several years due to the concerns of the lack of guidance that the TPG meant.

Practitioners need for further clarity on the comparability aspect has been addressed by the OECD, as the BEPS report do explain the comparability factors and adding more factors which is intended to work for intangible assets. The BEPS report also explains the most preferable methods to valuate intra-group transactions with intangibles (thought in this aspect not all guidance are presented yet). However, as the thesis shows, the scope of the new guidelines increased considerably.

The BEPS action 8 has increased the scope as the enlargement of the guidelines has come to establish that the taxation of profits from transactions involving intangible assets should be based on where that value is created, which requires the MNEs to have information on the function performing entities, entities contributing with assets as well as the entities who is responsible for the different risks assumed, in each transaction performed. The enlargement of the scope also includes the comparability aspect where functionality analysis based on the above mentioned responsibility. Even though the OECD provides a list of comparable factors, this list is not exhaustive and other factors can be used, leaving the comparability analysis to be very argumentative. As well in choosing a valuation method has enlarged the scope of the intangible assets guidelines, as the opportunity to use other valuation methods than the five acknowledged, also this is very argumentative.

The objectives in the BEPS report on valuation, is to prevent base erosion and profit shifting to protect countries tax revenues. This object has been reached with the action 8 report leaving tax authorities with the possibility to more insight in MNEs business operations. However, it seems that the OECD has become more political in their guidance as the initial objective, to provide clear and cohesive guidance without increasing the compliance burdens to non-proportionate and unreasonable level, is let go.

Due to this change, the MNEs will need to provide more information on why and how an arm’s length price is set on the intra-group transaction. The outcome of the valuation project
also means that small changes in the business reasons and objectives with the transactions, due to questionings from the tax authorities or other reasons, will have an increased effect on the value of that intangible. The argumentation that is needed in the set price will make it very difficult for MNEs to foresee tax consequences on the intra-group trade even for MNEs who tries to be as legit and compliant as possible.

As the thesis has shown, the objective to provide clarity to the TPG on valuation of intangible assets has to some extent been fulfilled, as well as the objective to prevent BEPS. However to prevent BEPS the action 8 puts a huge burden on MNEs to document the value of transactions with intangibles. Documentation that is highly argumentative and could be questioned by tax authorities, leaving the valuation of intangible assets to a very uncertain destiny.
Appendix

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