*Piergiorgio Valente**

# Transfer Pricing: Valuation of Intangibles and Simplification – A Summary of Key Issues at the International Level

**In this note, the elected Chairman of the Fiscal Committee of the CFE, Mr Piergiorgio Valente, provides a general outline of issues regarding the valuation of intangibles in the transfer pricing context in light of the OECD's simplification initiative by way of introduction to the CFE Opinion Statements in this regard that follow.**

Transfer pricing is undoubtedly an international tax issue of topical interest to multinational enterprises. As global trade increases, uncertainty in the tax treatment of intercompany transactions, as well as double taxation, may increase. Transfer pricing relates not only to the setting of prices for goods and services supplied to related parties, but also to the structuring of transactions and financial relationships.

As stated in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations,[1] the concept of a transfer should not be confused with that of tax fraud or tax avoidance, although transfer pricing transactions might be carried out for such purposes. Referring to transfer pricing as "income shifting" might hinder effecting an accurate and thorough analysis of the subject matter.

An examination of any transfer pricing issue should necessarily include an analysis of the arm's length principle, as a concept generally accepted as the best possible means to set prices in intercompany transactions and avoid double taxation on international business. The arm's length principle is outlined in article 9 of the OECD Model (2010).[2] The spiralling increase in cross-border flows of intangible property has become a most important international taxation issue, and arguably the main issue facing tax authorities, multinational enterprises and tax practitioners worldwide. The latter, in particular, have acknowledged that some of the most difficult transfer pricing issues have always involved the area of intangibles.

As shown by the OECD project on intangibles, transactions pertaining to intellectual property in the ever-expanding global economy are playing an increasingly significant role, whilst a few complexities regarding the identification, valuation and transfer of intangibles lead to a careful review of existing transfer pricing methodologies and techniques. In substance, the tax treatment of intangible assets should warrant particular attention within the transfer pricing context.

The arm's length principle requires that multinational enterprises apply transfer prices in their controlled transactions that are in compliance with the prices that would have been applied to the same uncontrolled transaction between unrelated, independent enterprises under the same circumstances. The transfer pricing method adopted by a multinational enterprise constitutes a pivotal component in determining the arm's length consideration in a transaction involving the intercompany transfer of intangible property.

As identical transactions between unrelated enterprises are not common, transfer pricing methodologies tend to focus on comparable rather than identical transactions. However, where intangible assets are concerned, critical issues may arise even in determining a comparative analysis. In this context, a consequent shift of the focus on non-traditional methodologies, especially profit-split methodologies, might occur. These latter methodologies tend to rely in whole or in part on internal data rather than on data derived from comparable uncontrolled transactions.

Different methods may be selected under different circumstances. All variables should be assessed in determining the correct methodology for a particular transaction, bearing in mind that those variables may change over time, leading to a reconsideration of the methodology to be applied.

In the transfer pricing area, compliance and administration have also become rather complex, time consuming and costly, for both taxpayers and tax administrations alike. Taxpayers have to deal with numerous compliance requirements along with the uncertainty that generally surrounds tax positions involving transfer pricing, while tax administrations have limited resources to challenge complex cases. At the same time, transfer pricing has become one of the most controversial tax issues, with a growing number of disputes.

In recent years, the number of cross-border intercompany transactions has steadily increased and a large number of small and medium-sized enterprises (SMEs) have entered the international market. SMEs face more difficulties than multinational enterprises in view of their lack of know-

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1. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2010).
2. *OECD Model Tax Convention on Income and on Capital* (22 July 2010), Models IBFD.

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ledge, experience on the subject, and the availability of resources.

The OECD project on the administrative aspects of transfer pricing – including a review of practices that may be implemented by countries to optimize the use of taxpayers' and tax administrations' resources – focuses on simplification measures adopted by countries as part of their transfer pricing regimes. These include safe harbours, less stringent documentation requirements, reduced penalties, streamlined procedures, etc. The implementation of some transfer pricing simplification measures could result in advantages for both taxpayers and tax administrations alike.

From a taxpayer's perspective, such simplification measures should facilitate transfer pricing compliance, reduce related costs as well as transfer pricing litigation, and guarantee certainty with regard to tax positions.

From a tax administration perspective, these measures eliminate the risk of tax base erosion and create the opportunity to focus their limited resources on higher risk transfer pricing cases.

BOOK

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