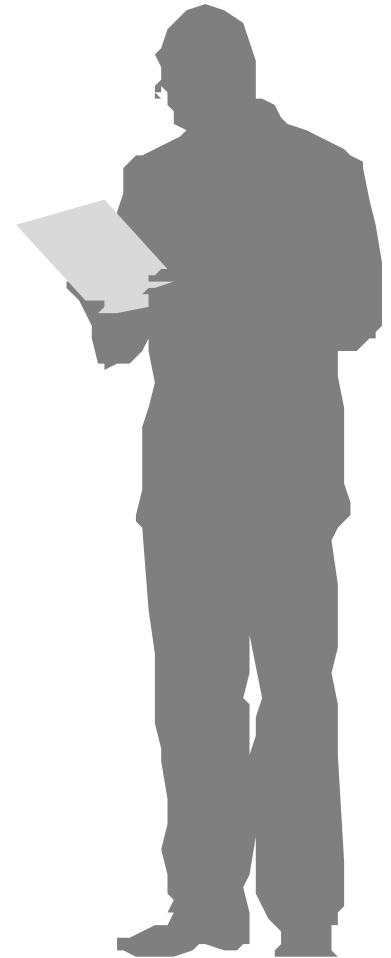

BEPS – Action Plan 8 to 10 (Intangibles)

September 2017

Agenda

- 1** Setting the Context
- 2** Intangibles- focus area in TP
- 3** Case studies



Setting the Context



15 Action Plans

1

Coherence

- Hybrid Mismatch Arrangements (2)
- CFC Rules (3)
- Interest Deductions (4)
- Harmful Tax Practices (5)

2

Substance

- Preventing Tax Treaty Abuse (6)
- Avoidance of PE Status (7)
- **TP Aspects of Intangibles (8)**
- **TP/Risk and Capital (9)**
- **TP/High Risk Transactions (10)**

3

Transparency

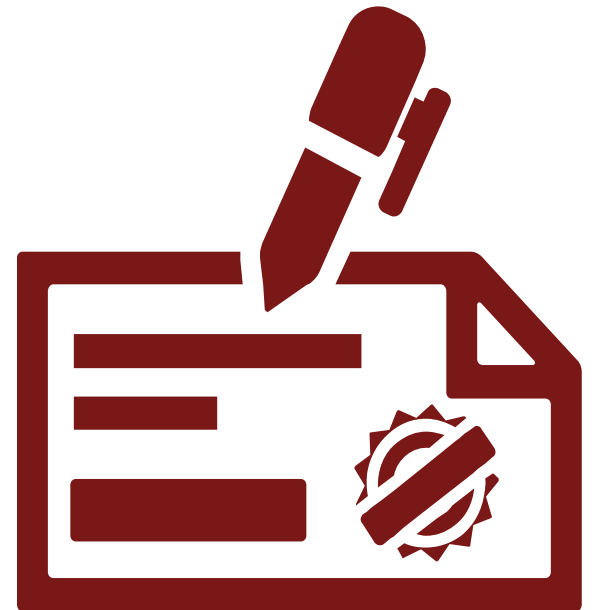
- Methodologies and Data Analysis (11)
- Disclosure Rules (12)
- TP Documentation (13)
- Dispute Resolution (14)

Place of value creation most important

Digital Economy (1)

Multilateral Instrument (15)

Intangibles – focus area in TP



Basic Definition

The term intangible in the Guidelines is defined as something,

- which is not a physical or financial asset,***
- which is capable of being owned or controlled for use in commercial activities, and***
- whose use or transfer would be compensated in a transaction between third parties.***

Patents

Trademarks

Group synergies

Know-how

Licenses

Market-specific characteristics

Goodwill

What is an intangible

Elements required to be an Intangible

- Capable of being owned or controlled
 - Does not include local market conditions such as size, competitiveness etc.
 - Does not include MNE group synergies which are not owned or controlled by a single member of an MNE group
- Capable of being used in commercial activities
- Use or transfer would be compensated in transactions between independent parties
- Not a tangible asset or a financial asset

Elements NOT required to be an Intangible

- Need not be an intangible for accounting purposes
- Need not be an intangible for general tax or treaty withholding tax purposes – Article 12 MTC
- Need not be legally protected
- Need not be separately transferable

Patents

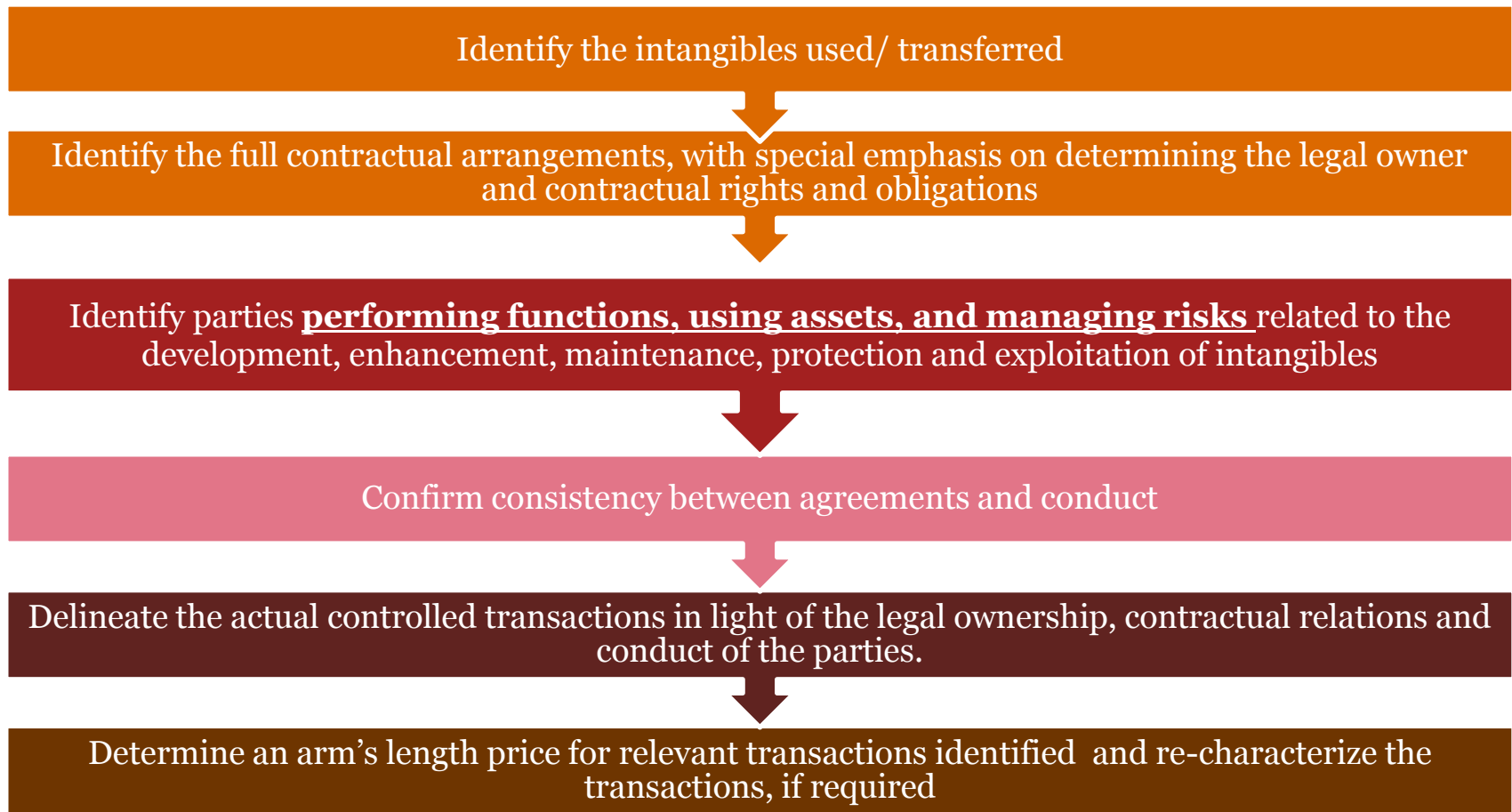
Know-how

Goodwill

Trademarks

Licenses

Six step framework of analysis of transactions involving intangibles



Functions related to intangibles

- Identity of entities performing functions:
 - **D**evelopment;
 - **E**nhancement;
 - **M**aintenance;
 - **P**rotection; and
 - **E**xploitation.
- An AE providing funding and assuming the related financial risks, but not performing any functions relating to the intangible, could generally only expect a risk-adjusted return on its funding.
- Merely providing funding but not performing functions or assuming risks entitled to no more than a risk free return.
- Control vis-à-vis outsourcing/subcontracting
 - Control is effectively a function and if outsourced must be compensated on an arm's length basis
 - If both the function itself and its control are outsourced, the legal owner would not be expected to retain any return attributable to that function (but it may retain returns related to funding and risk, depending on the facts)

Consideration for Transfer pricing study

- The functions, assets and risks of the respective parties to the transaction
- The business reasons for engaging in the transaction
- The perspective of and options realistically available to each of the parties to the transaction
- The competitive advantages conferred by the intangibles, including especially the relative profitability of products and services or potential products and services related to the intangibles
- The expected future economic benefits from the transactions
- Other comparability factors such as features of local markets, location savings, assembled workforce and MNE group synergies

Transfer of intangibles or rights in intangibles

- Transactions involving transfers of intangibles or rights in intangibles
 - Identify the nature of intangible
 - Identify any limitation on the rights transferred
 - Identifying transactions where intangibles are transferred in combination with other transactions undertaken (e.g. sale of goods or performance of services)
- Transactions involving the use of intangibles in connection with the sale of goods or provision of services
 - Consider intangibles at all relevant points in the comparability analysis
 - Identifying comparable transactions
 - Selecting the most appropriate method
 - Selecting the tested party

Key factors to determine arm's length price

- Exclusivity;
- Geographic scope;
- Useful life;
- Stage of development;
- Rights to enhancements, revisions and updates; and
- Expectation of future benefits.

Selecting the Most Appropriate Method

- Attention to be given to:
 - *nature of intangible*
 - *difficulty of identifying comparable uncontrolled transaction & intangibles*
 - *difficulty of applying certain transfer pricing methods*
- Cautions regarding the use of some methods
 - *Cost based methods discouraged except for limited application to matters involving internal use intangibles (except non-unique, non-valuable) intangibles*
 - *One sided methods (TNMM and RPM) not typically useful to directly value intangibles*
- Most useful methods
 - *CUP – where comparable transactions involving comparable intangibles can be identified*
 - *Transactional Profit split – sale of full rights or transfer of partially developed intangibles*

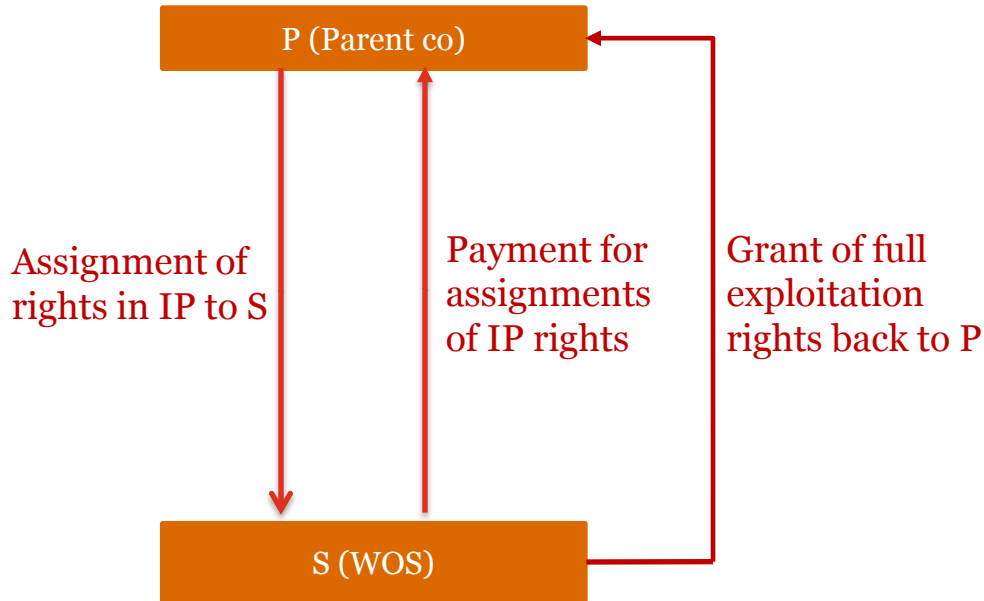
Valuation techniques

- Techniques based on discounted value of cash flows can be especially useful
 - Important caveat: Assumptions underlying application of valuation techniques must be carefully considered. Such techniques must be applied using assumptions that are consistent with the arm's length principle
- Assumptions to be considered:
 - Accuracy of financial projections
 - Assumptions regarding growth rates
 - Estimates of discount rates
 - Useful life and terminal values
 - Assumptions regarding taxes
 - Form of payment

Case Studies



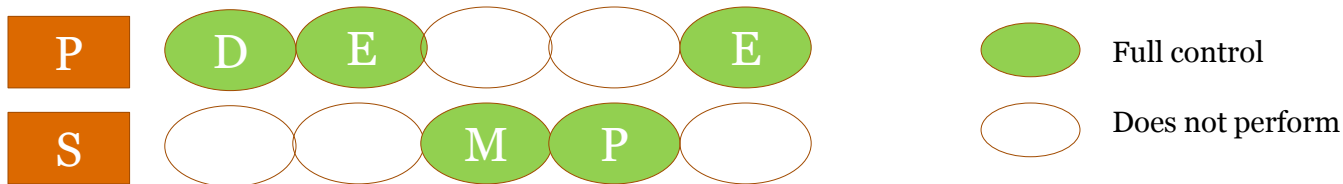
Situation 1



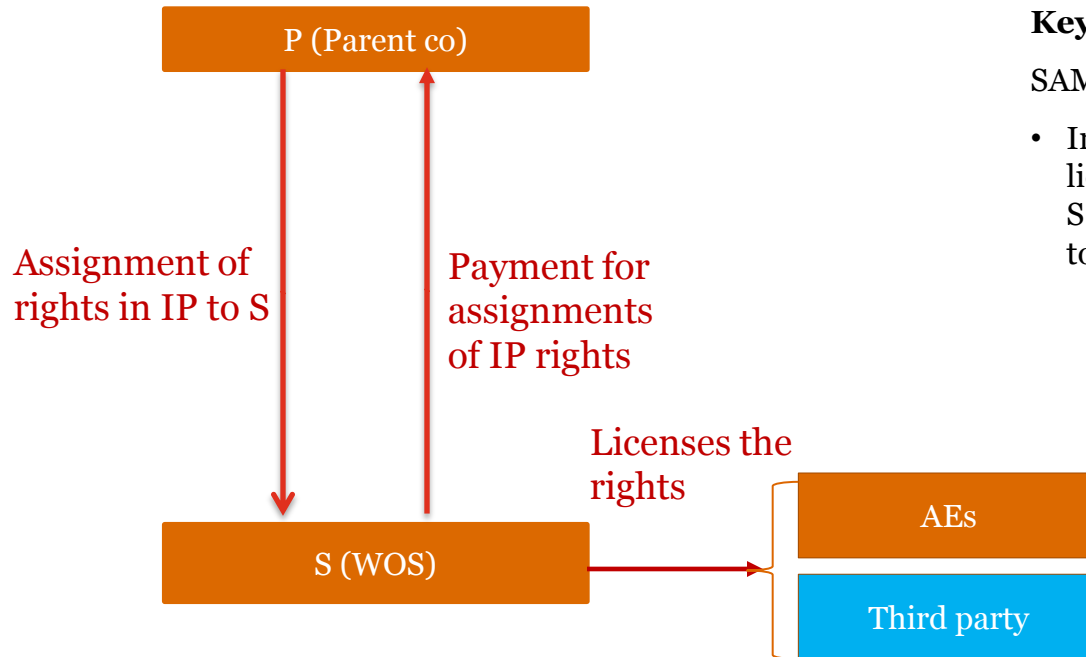
Key facts:

- P funds R&D and perform ongoing R&D activities.
- S does not conduct or control any of the R&D activities, it has no technical personnel, it does not incur any R&D expenses.
- As a policy, all rights of IP are assigned to S to centralize and simplify the global patent administration.
- S pays nominal fee to P for assignments of rights.
- S grant to P an exclusive, royalty free patent license with right to sub-license, for full life of IP.

Summary of functions:



Situation 2

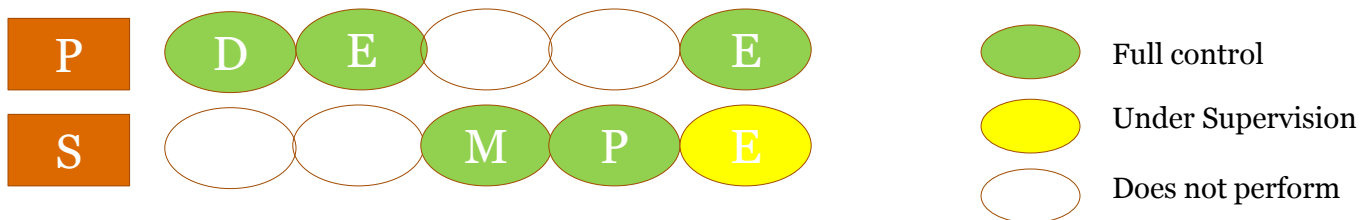


Key facts:

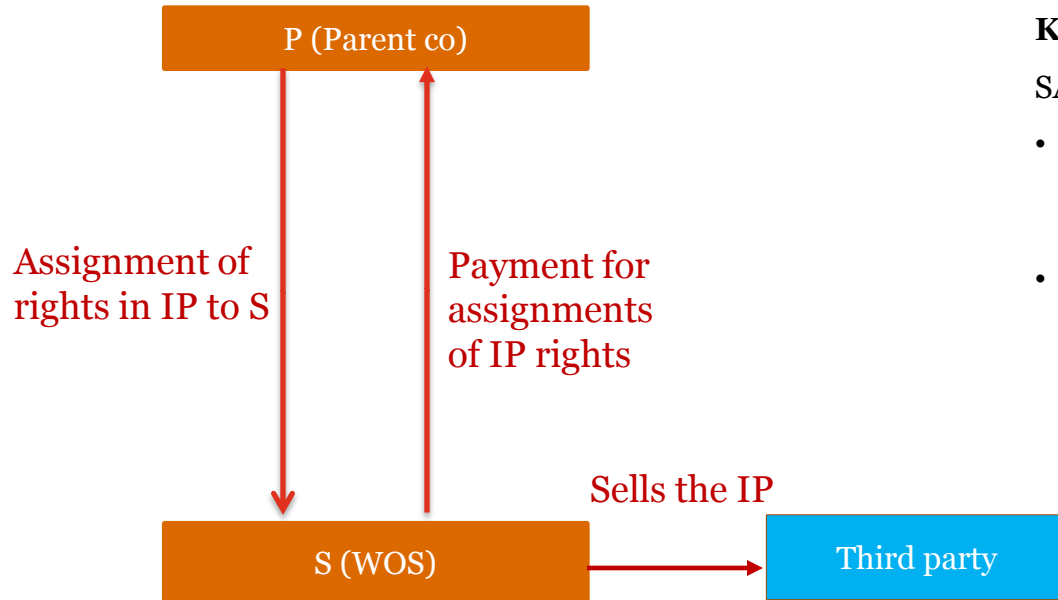
SAME FACTS AS IN SITUATION 1 EXCEPT:

- Instead of S granting exclusive, royalty free patent license with right to sub-license, for full life of IP to P, S under the control and direction of P sub-licenses it to AEs and third parties.

Summary of functions:



Situation 3

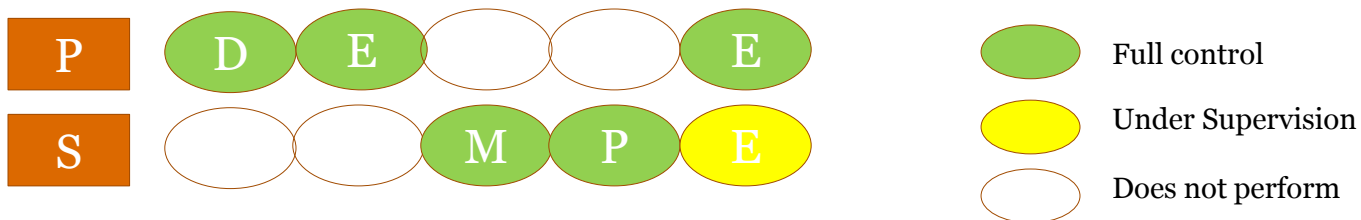


Key facts:

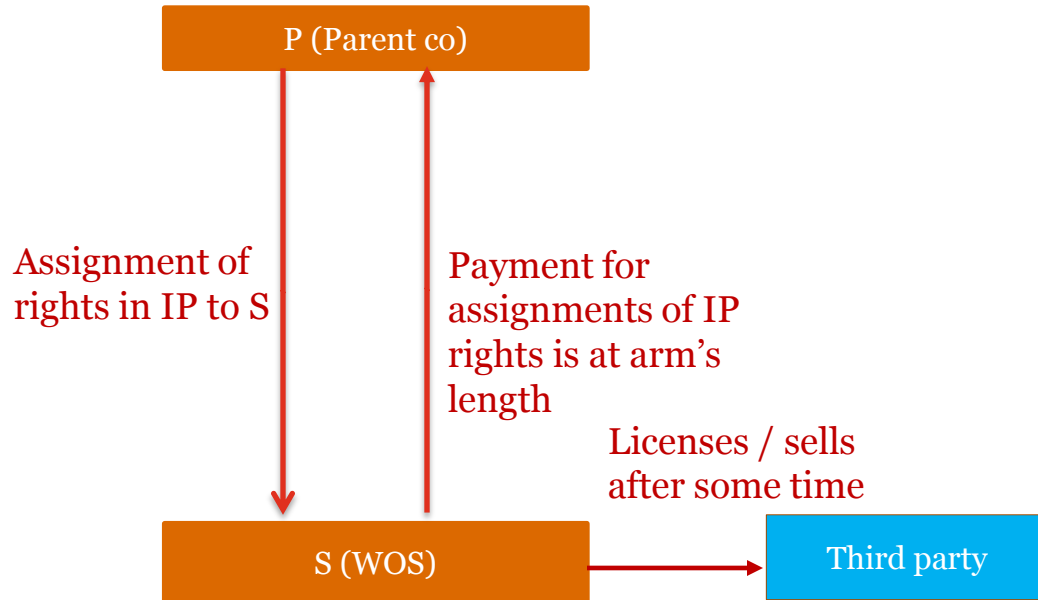
SAME FACTS AS IN SITUATION 2 EXCEPT:

- Instead of licensing the rights of IP to AEs and third parties, S sells IP to third parties under direction and control of P,
- The increase in price of IP is attributable to the period when S was the legal owner .

Summary of functions:



Situation 4

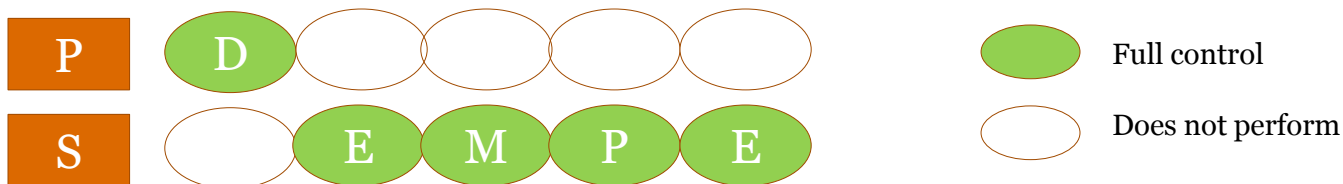


Key facts:

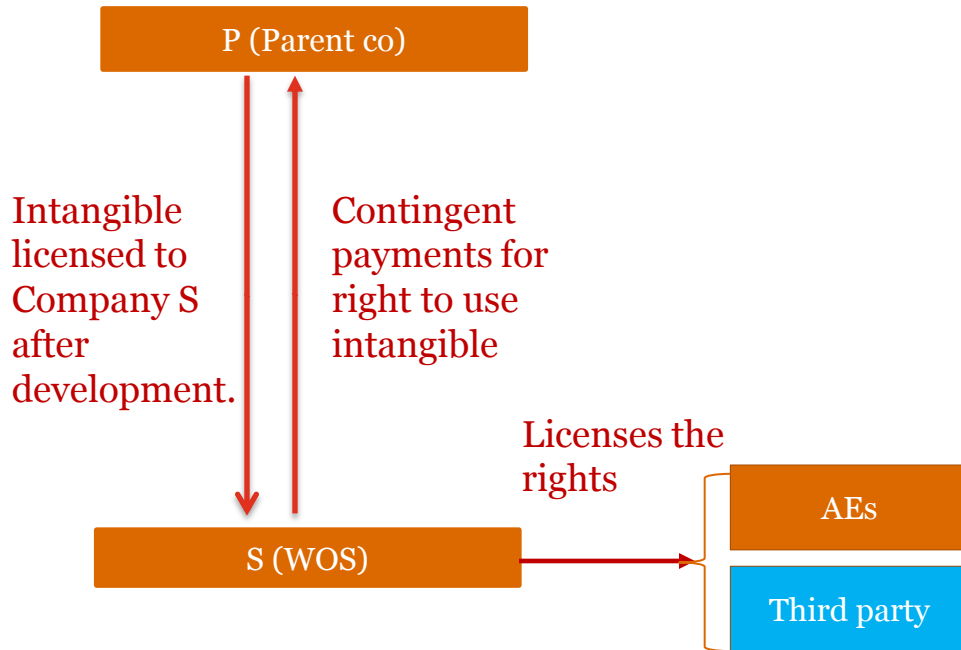
SAME FACTS AS IN SITUATION 3 EXCEPT:

- S has employees who make the decision to take on the patent portfolio and takes all decision relating to licensing programme, negotiation with licensees and monitoring compliance of third parties with term of licenses.
- S licensed the IP to third party and thereafter sells it to another third party at a price far exceeding the price paid by S to P for original purchase as the value of the patent has increased due to external unforeseen circumstances.
- S makes all decisions regarding sales. It manages and controls the disposition of the patents.

Summary of functions:



Situation 5



Key facts:

P & S decide to develop an Intangible

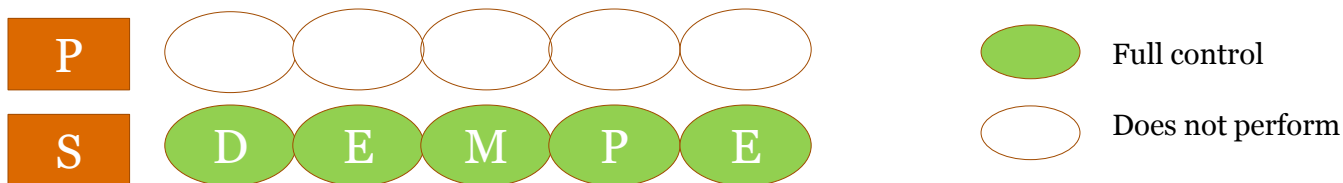
Functions of P

- Funds R&D and will be the legal owner of IP
- Contractually assumes and has the capacity to assume financial risk; and exercises control over the financial risk

Functions of S

- S has existing IP which will benefit the R & D functions. It has track record and experienced employees.
- Performs and control all R&D functions
- Key decision maker regarding development of IP.

Summary of functions:



Thank You