THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES

ICAEW REPRESENTATION

TAXREP 33/10

OECD: FUTURE PROJECT ON THE TRANSFER PRICING ASPECTS OF INTANGIBLES

Memorandum submitted in August 2010 to OECD by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to a request for comments on future OECD work in this area.

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INTRODUCTION

1. We set out our response to the request for comment published[1] on the OECD website in July 2010 in relation to the following:

    - 'What [ICAEW Tax Faculty] see as the most significant issues encountered in practice in relation to the transfer pricing aspects of intangibles;
    - What shortfalls, if any, [ICAEW Tax Faculty] identify in the existing OECD guidance;
    - What the areas are in which [ICAEW Tax Faculty] believe the OECD could usefully do further work; and
    - What [ICAEW Tax Faculty] believe the format of the final output of the OECD work should be.'

2. In evaluating any taxation policy we have for the past ten years used a set of core principles, *Ten Tenets for a Better Tax System* which are set out in Appendix 1.

WHO WE ARE

3. The Institute operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 132,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The Institute is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.

4. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.

5. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter TAXline to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

GENERAL COMMENTS

6. The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations was published in July 1995 and Chapter 6 is entitled *Special Considerations for Intangible Property* while Chapter 8 is entitled *Cost Contribution Arrangements*. OECD is now considering amending these two

[1] See http://www.oecd.org/document/55/0,3343,en_2649_33753_45565303_1_1_1_37427,00.html

chapters to provide more up to date and relevant guidance on the transfer pricing aspects of intangible property.

7. We agree that it would be appropriate for OECD to review the very significant changes that have taken place over the past 15+ years in relation to all aspects of intangible property and international trade and globalisation but we believe that the initial work should be directed less at amending the formal Transfer Pricing Guidance and more at producing an analytical study along the lines of the 2005 OECD report *Employee Stock Option Plans: Impact on transfer pricing*[2].

8. We believe that a greater number of countries are likely to participate in the preparation of such an analytical study than would potentially participate if the project were to be restricted to an update to the Transfer Pricing Guidelines which in many respects will be mainly of interest to the 31 member countries of OECD.

9. To the extent that broad general principles emerge from the analytical study, on which there is general agreement, then these should be incorporated into the Transfer Pricing Guidelines.

10. This incorporation into the Transfer Pricing Guidelines will also be beneficial in respect of non OECD countries as we are aware that the tax authorities in those countries do pay significant attention to the OECD Guidelines.

11. Business is particularly concerned that there should be certainty as to the tax outcome of their business activities throughout the world.

12. In order to achieve that we believe there needs to be a greater understanding of the nature of intangible property and the economic role that it now plays in the way the business operates in countries around the world. Many of these countries are not members of OECD which is why we have recommended that OECD should pursue an analytical study which is likely to be of interest to a very large number of countries in addition to the membership of OECD.

13. When investigating the nature of intangible property we believe that OECD can usefully look to the work that has already been carried out by the International Accounting Standards Board which has had to consider the question in order to provide rules on accounting for intangibles. IAS 38 considers intangible assets in detail and they are considered further in IFRS 3 which deals with accounting for business combinations. IFRS have now been widely adopted in countries around the world, and new countries continue to adopt them, so there is a good common basis between countries for a discussion of the characteristics of an intangible in a way which is going to be recognised and understood by business.

14. It might be relevant for some of this work to be taken forward in the context of the extended global dialogue on tax and development. Following the joint meeting in January 2010 involving the Committee of Fiscal Affairs and the Development Assistance Committee we are aware that a Task Force including business and industry representatives, as well as developing countries, has been set up and one of the areas they will consider is transfer pricing. The Task Force may provide a useful forum for the discussion and development of some of these issues in their wider context. In addition, we welcome the planned consultations between Working Party 6 and key non-OECD economies, and we support the

[2] http://www.oecd.org/dataoecd/35/37/33700408.pdf

fact that a start has been made through the OECD's Advisory Group on non-member co-operation.

15. It might also be helpful to consider some of the wider implications arising from the increased focus on intangibles in the revised Chapters I-III and the new Chapter IX of the updated Transfer Pricing Guidelines which have just been published.

16. We believe that the work of OECD also ought to take account of the enormous developments over the past 15 years caused by the advent of the internet and the massive increase in online trading and other activities. These have had an enormous impact on the way corporations trade both domestically and across borders. E-commerce also provides the means to transfer valuable intangible property to associated companies.

17. We believe that the analytical study that we are recommending would also have an educational impact and with better understanding would produce more effective audits when tax administrations are investigating the transfer pricing aspects of intangible property.

18. We are concerned that there is sometimes a belief that anything that is not tangible must be an intangible and have a value attaching to it, for example the right to do business.

19. We are also concerned that some tax authorities argue for an ever increasing range of 'soft' intangibles and ascribe a value to them in order to enhance their tax revenues.

20. There is also sometimes a view that intangibles are always linked to revenues and so are inherently valuable whereas in many instances they may be linked to costs. For instance a more efficient way of carrying on one's fundamental business.

21. Indeed in our experience there are differing sectoral types of intangible property and value creation may take different forms. Which is why we are recommending that an initial, broad ranging, study which creates a better understanding of all these factors and issues should precede any work to specifically amend the Transfer Pricing Guidelines themselves.

22. We also believe that the OECD study should look at other taxation issues within a single country. For instance while the key focus at the moment may be on the transfer pricing issues, and the direct tax impact, the intangibles may be attributed to a physical product on which for instance customs duties are levied. Alcoholic drinks would be an example. If a particular country wants to change the value of the transaction for direct tax purposes there is for instance no mutual agreement procedure within the single country to look at the customs duty impacts of any changed value.

23. Finally, in terms of general points, we believe that the analytical study should look at the nature of the CUP (Comparable uncontrolled price) method when intangibles are concerned and, in particular, brands. The nature, and aim, of many companies with world leading brands is to be the number one participant in any geographical country/area in relation to their (branded) product. The inevitable consequence of that is that there are unlikely to be comparable products in respect of which the CUP method can be easily applied. We believe

that there needs to be a better understanding of the flexibility with which the CUP method needs to be applied in such circumstances.

SPECIFIC COMMENTS

WHAT ARE THE MOST SIGNIFICANT ISSUES ENCOUNTERED IN PRACTICE IN RELATION TO THE TRANSFER PRICING ASPECTS OF INTANGIBLES?

24. We believe that the proposed study by OECD would clarify the nature of intangibles, and the role they play in business.

25. It is the different understandings that create confusion and undermine the certainty that is a key requirement for business.

WHAT SHORTFALLS CAN BE IDENTIFIED IN THE EXISTING OECD GUIDANCE?

26. In the 15 years since the OECD Transfer Pricing Guidelines were published there has been an enormous expansion in the existence, range and importance of global brands which allow ostensibly similar products to be sold in greater volumes and at higher prices than might otherwise have been the case.

27. Chapter VI, section 6.2, of the Transfer Pricing Guidelines sets out what intangible property includes but it did not, in 1995, address the issue of brands as brands were not of such great relevance at that time.

28. We also believe that when amendments are made to the Guidelines it would be helpful to consider the economics of intangibles, the many and various ways in which they can create value and how they can potentially impact on the value chain of business. Any valuation will also need to take into account the way in which the intangibles may be recognised and protected, for instance under relevant trademark, patent and copyright rules.

29. The valuation of intangibles then needs to be consistent with the analysis of the economic role played by a particular intangible.

WHAT THE AREAS ARE IN WHICH THE OECD COULD USEFULLY DO FURTHER WORK?

30. As we have said above we believe that the output of the initial work of OECD in the area of intangibles should be an analytical study of the current situation to create a better understanding of the nature of intangibles and the (economic) role they now play in business.

31. The study should look at the different types of intangible and the underlying economics of intangibles.

32. We believe the study should also address issues of legal and economic ownership as there are currently widely different views on, for instance, the extent to which advertising or promotion of a brand creates some sort of ownership.

WHAT SHOULD BE THE FORMAT OF THE FINAL OUTPUT OF THE OECD WORK?

33. For the reasons set out above we believe that the initial aim of the proposed work in this area should be the publication of an analytical study of the issues raised. It would then be extremely useful for this to be followed by suitable amendment to the Transfer Pricing Guidelines to the extent that general principles emerge from the analytical study that can be agreed unanimously as suitable for inclusion in the Guidelines.

IKY
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APPENDIX 1

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

Any tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see http://www.icaew.com/index.cfm?route=128518).