Agenda

- Introduction – Questions raised by OECD Secretariat
- Analysis of concept “Value Driver”
- Value drivers and ongoing use
- Change of use
- Summary
Value Driver: Questions raised by the secretariat

► Assumption: Value Driver is something that contributes to the creation of an MNE’s income but is not an asset in the accounting sense.
► What difference does this make in a transfer pricing analysis?
► How should the distinction be described if such a distinction is appropriate?
► Are private ownership and transferability important factors to consider in making such a distinction?
► Are there other important factors?
Some examples of value drivers

Examples of attributes of a business which it may be claimed should be treated as intangibles for which an arm’s length remuneration should be paid/received include:

- First mover advantage
- Superior management
- Risk bearing activities
- Workforce-in-place
- Scale
- Future profit potential
- Goodwill
- Network intangibles
- Barriers to entry
- Going concern
Clustering value drivers

► Features of the market driving profitability
► Characteristics of the enterprise
► Value inherent in future strategic options to which the enterprise is not yet committed
► Attributes related to being part of a group

► Last two will be discussed in other presentations
Relevance: Two different situations

► Remuneration of functions ‘making use’ of the ‘intangibles’
► Remuneration in relation to any change of the ownership/use
Ongoing use: Relevance for comparability analysis

- Market features: Relevant in conducting a comparability analysis (see par. 1.55 TPG). In general, reasonably reliable analysis possible.
- Ownership, accounting treatment less relevant for market features.
- Characteristics of the enterprise: theoretically relevant, but certain characteristics may be very subjective, may be cause of a lot of disputes.
- Example: is management of the tested party better than management of comparables?
- Suggested approach: only take into account when reasonably reliably assessable (objectivity).
- Based on current guidance (e.g. comparability adjustments, use of a range, recognition of non-ideal world par. 3.38), taking into account practical considerations.
“2.4 There are situations where transactional profit methods are found to be more appropriate than traditional transaction methods. For example, cases where each of the parties makes valuable and unique contributions in relation to the controlled transaction, [...] may make a transactional profit split more appropriate than a one-sided method.”

“2.109 A transactional profit split method may also be found to be the most appropriate method in cases where both parties to a transaction make unique and valuable contributions (e.g. contribute unique intangibles) to the transaction, because in such a case independent parties might wish to share the profits of the transaction in proportion to their respective contributions and a two-sided method might be more appropriate in these circumstances than a one-sided method. In addition, in the presence of unique and valuable contributions, reliable comparables information might be insufficient to apply another method.”

Now what if good management = value driver = valuable and unique contribution. Apply profit split in more cases?
Conclusion ongoing use

- Some examples of value drivers are relevant for comparability analysis, specifically market features.
- For market features, the accounting perspective and ownership perspective are not relevant (e.g., economic circumstances are not accounted for in balance sheet, there is no ownership).
- Some examples may from a *theoretical* perspective be relevant (e.g. good management) but would cause a lot of practical issues and may ultimately lead to double taxation.
- From a practical perspective, only factors that can be established in an reasonably reliable (objective) way should be considered. As such, ownership and accounting do play an important role.
- Recognizing value drivers as an unique and valuable contribution would increase the use of profit split.
Change in ownership/use

► Key question: should the change in use of a value driver lead to a taxable event?
► Suppose as a starting point the criterion: “Whether a third party would be willing to pay for it” would be used.
► Important question then would be: how to establish in a reasonably reliable way whether this is the case?
Practical aspects: Example I oligopoly

► Company X in country A, operating in an oligopolistic environment, is taken over by Company Y.
► There are high barriers to entry in this market.
► The group decides to change A’s business model (fully fledged -> low risk service provider).
► Large part of functions in country A are terminated and risks are actually transferred to company Y.
► Assume Y is willing to pay for the oligopolistic position, but not for the good management (since it has its own superior management).
► How to determine profit attributable to oligopolistic position? Even profit of least earning comparable company may partly originate from good management of that company.
Practical aspects: Example II immature market

- Company X is active in a country A with an underdeveloped touristic sector. As one of the ‘first movers’ company X makes good profits. Assume for sake of discussion that no specific knowledge etc is needed.

- Company Y is willing to enter this market. There are no barriers to entry. Company Y can choose to either take over Company X’s business or to set up it’s own business. To avoid registration costs, Company Y decides to take over Company X’s business.

- In such a case, Company Y would not be willing to pay for the “oligopolistic position”. It may pay for the savings in administrative expenses, given the options available.

- Conclusion: A third party will not always be willing to pay for entering into a market with a limited number of players.
Conclusions change in use

► Change in use of value drivers should not lead to the conclusion that there is a taxable transfer of something of value per se.
► A factual analysis is needed.
► Unless objectively established that a third party would be willing to pay for it, no taxable event should be considered.
► Concrete examples of third party transactions may be helpful as support. Ownership and transferability. The absence of 3rd party transactions (and the fact that a value driver cannot be owned) should be a strong (or even decisive) indicator that 3rd parties would not be willing to pay for it.
► No presumption should be made that there is a taxable event. This would (re)introduce ”picture before vs. picture after thinking”.
► Since objective third party information often is not available, there is an important role for the use of taxpayer information (decision making process etc.).
► To avoid double taxation, it should not make a difference whether there is an outbound or an inbound ‘transfer’.
Summary

► Value drivers can be split in several clusters.
► The analysis of the importance of value drivers can be split in the analysis of the ongoing use and the change of use.
► Market features are relevant for the comparability analysis.
► Characteristics of an enterprise may be theoretically relevant for the comparability analysis, but should only be taken into account when a reasonably reliable comparison can be made.
► There should be no presumption that change in use of value drivers should lead to the conclusion that there is a taxable transfer of something of value per se.
► Unless objectively established that a third party would be willing to pay for it, no taxable event should be considered. The absence of comparable 3rd party transactions (and the fact that a value driver cannot be owned) should be a strong (or even decisive) indicator that 3rd parties would not be willing to pay for it.
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