

Straight from the source— OECD on course for draft guidance on transfer pricing for intangible assets

November 2011

It seems only appropriate that three days of consultations between the Organisation for Economic Co-operation and Development (OECD), and multinational businesses and experts on the future of the transfer pricing aspects of intangible assets would have taken place in a Paris—city of global brands and “un certain je ne sais quoi.” This important matter influences the ability of tax administrations to identify, ascribe ownership rights, value and, ultimately, tax profit from the business of developing and exploiting intangible assets—those assets highly critical to the business operations and future value of multinational companies.



Intangible assets have a sense of “je ne sais quoi” themselves—an idea that value is somewhere present in a highly collaborative multinational group but elusive. Intangible assets elicit an emotional response that may cause repeat product purchases or realization of a pricing premium. This makes intangible assets hard to identify and value, and such uncertainty has led to significant controversy with tax authorities for some of the world’s most intangible-dependent multinationals. Such controversy often results in double taxation—especially in the case of transactions of intangible asset rights between tax jurisdictions that don’t have a treaty that can be used to eliminate this double tax.

The OECD has decided that it’s time to modernize its guidance to tax administrations and taxpayers to equip all parties to deal with modern business realities, and reduce the severity and cost to businesses of controversy with tax authorities. This OECD project comes at a particularly relevant time, as countries are incurring budget deficits, allowing national debts to expand in the interest of stimulating economic activity, seeking to maximize tax revenue through more enforcement and collection activity, and becoming ever-more vigilant over tax leakage to low-tax jurisdictions.

The first area of controversy relates to the definition of an “intangible asset.” Businesses are adamant that intangible assets be defined as those assets that are protectable under law, tradeable, and separable from other assets. Tax authorities view this definition as unnecessarily narrow, but they will have a difficult task moving between financial accounting, valuation and legal definitions to arrive at a practical definition. Great uncertainty over the consideration of accounting assets such as goodwill, going concern and workforce-in-place as intangible assets is expected to serve as a significant barrier to the OECD members reaching consensus, as different countries are net importers or users of intangible assets and other countries are net exporters or developers of intangible assets. Clearly, the less workable existing definition of an intangible as “something of value” must be replaced.

Certain types of non-tradeable intangible assets may not appropriately be viewed as intangible assets themselves, but instead as key factors influencing company profit (profit drivers) that should be considered when selecting a transfer pricing method. Alternatively, non-tradeable intangible assets may be more appropriately considered as factors of comparability when conducting pricing analysis.

The OECD working party has the difficult task of deciding what goodwill is from a transfer pricing standpoint, who should own goodwill, and how goodwill has a bearing on the determination of an arm’s length transfer price. Many commentators questioned the relevance of using financial accounting goodwill to specify intangible asset value, citing examples of excessive share purchase values in comparison to normal multiples and the general lack of a practical connection between goodwill value for accounting and value of a taxable transaction of an intangible asset.

Critical to the OECD project will be the development of some guidance concerning the determination of ownership of intangible assets for transfer pricing purposes. The clearest definition of ownership is legal, but it is apparent that a practical definition is needed, and that evidence of non-routine profit being earned by a non-legal title holder can be found in court cases and other commercial examples of actual third-party commerce. The concept of ‘economic ownership’ is widely viewed as poorly defined and misused, so the challenge for the OECD working party drafting the new guidance will be to write a definition that recognizes legal title but allows the arm’s length principle to be put to work in resolving ownership disputes between tax jurisdictions.

Brands are often highly valuable and have values that are difficult to quantify. Harder yet is the attribution of profit to members of a multinational group who develop a brand together, but do not all hold legal title to key elements of the brand such as images, logos, and trade names. The OECD is clearly interested in modernizing its understanding of the definition of a brand and how to identify brand value. Guidance from the ISO 10668 standard and other systematic ways of identifying and valuing intangibles are being evaluated by the OECD working group.

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The practical experiences of OECD member countries in dealing with intangible assets are of interest to the OECD as it develops broader guidance. The Australian tax authority (ATO) approach to marketing intangibles was presented. This approach weighs heavily in favour of respecting legal ownership. The ATO suggests that in an arm's length scenario, a marketer does not acquire economic ownership of intangibles it does not legally own, no matter how much market activity it performs or how much value it adds to the intangibles. Further, it suggests that an arm's length outcome can be arrived at without the necessity to recognize economic ownership. To date, however, there hasn't been any significant practical application of these rules by the ATO. There also continues to be difficulty getting OECD consensus on the issue of allocation of profit from the development and use of marketing intangibles, including agreement on examples that illustrate real life scenarios.

Corporate synergies were also discussed. It was noted that in certain instances these synergies may result in incremental returns relative to the returns for similar entities on a stand-alone basis or they may simply help to maintain the competitiveness of a firm without improving profitability. It was also argued that negative synergies often result from corporate mergers, suggesting that corporate synergistic potentials were highly uncertain, difficult to quantify in practice and should not be regarded as intangible assets transferable between legal entities. Tax authorities were urged not to loosely apply their own conclusions in light of perceived synergy potentials and to accept a taxpayer's transactions that do not contradict economic and commercial rationality.

Businesses clearly want certainty from the OECD guidance so that the same transaction is not treated differently by two tax authorities, or taxed more than once. CFOs and Tax Directors want to be able to continue supporting their businesses and avoid becoming mired in transfer pricing controversy.

Tax authorities want a broad definition of intangible assets so that there is minimal limitation to deeming a valuable transaction of an intangible asset and reassessing tax on a share of the profit generated in the multinational group. At the same time, tax authorities seek guidance and examples in order to be able to effectively conduct international tax audits and manage the resolution of double tax matters through the government-to-government Competent Authority process.

Grant Thornton participated in these meetings and was pleased to provide its perspectives as an adviser to dynamic multinational businesses to the OECD, business and the tax authority delegates. We are watching the development of the OECD guidance with interest, will remain mindful of what we heard as we deliver advice to our clients, and will keep you up to date on developments as the project progresses to draft guidance in the form of a revised Chapter VI of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Authorities.



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