

THE TRANSFER PRICING OF INTANGIBLES

BY
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by

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The Transfer Pricing of Intangibles

To Peter

Soli Deo Gloria

PREFACE

In the 21st century, the spiralling increase in cross-border flows of intangible property has become a major international taxation issue, and arguably *the* main issue facing revenue authorities, multinational enterprises and tax practitioners around the world. Not only is an increasingly significant role being played by transactions involving intellectual property in the ever-expanding global economy, but the manifold complexities associated with identifying, valuing and transferring intangibles make this an issue requiring a creative review of existing transfer pricing methodologies and techniques.

In the United States, a nation at the forefront in transnational dealings and that has promulgated the most sophisticated, comprehensive and aggressive transfer pricing rules, it is generally acknowledged that the business environment has undergone dramatic changes vis-à-vis the importance of intangible assets in international dealings during the last two decades, requiring a fresh look at this issue.

In Europe, in response to the growing concern regarding the tax treatment of intangibles in international transactions, the Organisation for Economic Cooperation and Development, an organization which facilitates the increasing economic interdependence of the developed countries by harmonizing as far as possible their systems of business taxation, issued Chapter VI of its *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* in March 1996. This chapter deals with Special Considerations for Intangible Property, and attempts to address the difficulties of evaluating intangible property transactions for transfer pricing purposes.

Likewise, in the 1990s Australia realized the importance of a competitive high technology industry to its future economy, and the need to ensure the adequate taxation of the cross-border supply of intangibles. The need for a more in-depth analysis of the methodologies for the taxation of intangibles has been acknowledged.

A comparative analysis of the US, OECD and Australian perspectives on the transfer pricing of intangible assets therefore represents an examination of attitudes at the forefront of this rapidly evolving area of taxation law. (It should be borne in mind that Australia signed the world's first transfer pricing Advance Pricing Agreement with the US in 1991). Both new avenues and key concepts are explored in an attempt to realize an improved transfer pricing policy for intangible transactions in the new millennium.

This book not only highlights the current problems encountered in inter-affiliate transactions of intangible property, but also attempts to offer a variety of solutions to these problems. Chapter 1 illustrates how the tax treatment of intangibles in the context of transfer pricing has become a major international tax concern. Chapter 2 focuses on

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certain definitional issues which are vital to an understanding of transfer pricing in the wider context, and also to an understanding of the specific issue of the transfer pricing of intangibles from a comparative viewpoint. It addresses issues related to an application of the arm's length principle to intangible asset transactions. Chapter 3 examines the determination of legal and economic ownership of group intangible assets, along with the thorny issue of intangible asset valuation and transfer. Chapter 4 considers the transfer pricing methodologies utilized in determining an arm's length consideration for intangible property, including transaction-based and profit-based methodologies.

In Chapter 5, global formulary apportionment is considered as a possible solution to the specific problems of inter-affiliate transfers of intangibles. Chapter 6 discusses the transfer pricing documentation requirements in both the United States and Australia, along with the penalties for non-compliance. It offers recommendations for the resolution of problems experienced with these documentation requirements. Chapter 7 examines the available administrative approaches to the resolution of transfer pricing disputes, while Chapter 8 offers an in-depth investigation of the advantages and disadvantages of utilizing an Advance Pricing Agreement to overcome some of the inherent difficulties of cross-border intangible asset transfers. Chapter 9 summarizes and highlights the main recommendations made in the previous chapters.

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Michelle Markham
Gold Coast, Australia
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Freedom of Information Act 1982 (Cth)

Income Tax Assessment Act 1936 (Cth)

Industry Research and Development Act 1986 (Cth)

Privacy Act 1988 (Cth)

SUMMARY OF ABBREVIATIONS

AASB	Australian Accounting Standards Board
APA	Advance Pricing Agreement/Arrangement
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AUD	Australian currency
BALRM	Basic Arm's Length Return Method
BAPA	Bilateral Advance Pricing Arrangement
BNA	Bureau of National Affairs (US)
BIAC	Business and Industry Advisory Committee to the OECD
CBT	Consolidated Base Taxation
CEDA	Committee for Economic Development of Australia
CCA	Cost Contribution Arrangement
CRA	Canada Revenue Agency
CFE	Confédération Fiscale Européenne
CPM	Comparable Profits Method
CPSM	Comparable Profit Split Method
CUP	Comparable Uncontrolled Price
CUT	Comparable Uncontrolled Transaction
DTA	Double Taxation Agreement
DTR	Draft Taxation Ruling
EC	European Community
EU	European Union
EU JTPF	European Union Joint Transfer Pricing Forum
EUR	Euro
FAS	Financial Accounting Standards
FASB	Financial Accounting Standards Board
FDI	Foreign Direct Investment
FOI	Freedom of Information
FOIA	Freedom of Information Act (US)
GAO	General Accounting Office (US)
IAS	International Accounting Standard
ICC	International Chamber of Commerce
IP	Intellectual Property
IRC	Internal Revenue Code (US)

Summary of Abbreviations

IRS	Internal Revenue Service (US)
IT	Information Tecnology
ITAA	Income Tax Assessment Act (Australia)
ITAC	Information Technology Association of Canada
JWG	Joint Working Group
LDCs	Less developed countries
MAP	Mutual Agreement Procedure
MEMAP	Manual on Effective Mutual Agreement Procedure Practices
MNE	Multinational Enterprise
MNC	Multinational Corporation
MTC	Multistate Tax Commission
OECD	Organisation for Economic Cooperation and Development
OLI	Ownership, Location and Internalization
PATA	Pacific Association of Tax Administrators
PFC	Prefiling Conference
PLI	Profit Level Indicator
PSM	Profit Split Method
R&D	Research and Development
RPM	Resale Price Method
RPSM	Residual Profit Split Method
SBT	Small business taxpayer
SDR	Supplementary Dispute Resolution
SEC	Securities and Exchange Commission
SIC	Standard Industrial Classification
SMEs	Small and medium enterprises
TAG	Technical Advisory Group (of the OECD)
TEI	Tax Executives Institute
TNC	Transnational Corporation
TNMM	Transactional Net Margin Method
TPM	Transfer Pricing Methodology
UDITPA	Uniform Division of Income for Tax Purposes Act (US)
UNCTAD	United Nations Conference on Trade and Development
USCIB	United States Council for International Business
USD	United States currency

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