



OECD releases discussion draft on implementation guidance on approach to Hard-to-Value Intangibles for tax administrations

Background

The Final Report on Organisation of Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan 8-10 - 'Aligning Transfer Pricing Outcomes with Value Creation' (Action Plan – 8-10), mandated the development of guidance on the implementation of the approach to pricing hard-to-value intangibles (HTVI).

On 23 May 2017, the OECD released a discussion draft providing guidance on the implementation of the approach to pricing transfers of HTVI. The purpose of this guidance is to reach a common understanding and practice among tax administrations on how to apply adjustments resulting from the application of the approach for HTVI, so as to improve consistency and reduce the risk of economic double taxation.

OECD has sought public comments on this discussion draft by 30 June 2017. This discussion draft does not represent a consensus position of the Committee on Fiscal Affairs or its subsidiary bodies but presents the principles that should underline the implementation of the approach to HTVI.

For better comprehension, the discussion draft also provides examples illustrating the application of this approach, and addresses the interaction between the approach to HTVI and the mutual agreement procedure under an applicable treaty.

Important considerations

Principles underpinning the application of the approach to HTVI:

- Tax administrations can consider ex post outcomes as presumptive evidence about the appropriateness of the ex ante pricing arrangements → significant differences between ex post outcome and ex ante pricing presents presumptive evidence probability weighing of which shall require further scrutiny of underlying factors.
- The ex post outcomes inform the determination of the valuation that would have been made at the time of the transaction; however, it would be incorrect to base the valuation on the actual income or cash flows without taking into account the probability of achieving such income or cash flows at the time of the transfer of the HTVI → Essential to evaluate, what was known and could have been anticipated at the time of entering into the transaction involving the HTVI and also taking into account the probability of achieving the actual income or cash flows, at the time of the transaction.
- Where a revised valuation shows that the intangible has been transferred at undervalue or overvalue compared to the arm's length price, the revised value of the transferred intangible may be assessed to tax taking into account contingent payments and price adjustment clauses, irrespective of the payment profiles asserted by the taxpayer → Tax administrations may make appropriate adjustments, including adjustments that reflect an alternative pricing structure (for example, milestone payments, running royalties with or without adjustable elements, price adjustment clauses, or a combination of these).

- Tax administrations should apply audit practices to ensure that presumptive evidence based on ex post outcomes is identified and acted upon as early as possible → Countries may consider targeted changes to procedures or legislation (say, introduction of a requirement to notify promptly the transfer or licence of an intangible falling within the HTVI definition).

In the actual implementation of the HTVI approach, the guidance in the discussion draft acknowledges the fact that, the elapsed time between the transfer of the HTVI and the emergence of ex post outcomes may not always correspond with audit cycles or with administrative and statutory time periods. However, it also notes that there is already a time-lag between the time when the transaction is undertaken and the time when it is scrutinised by the tax administrators, thus, the impact of timing issue may not be overstated. Thus, it is emphasised on early identification of the transactions involving HTVI and initiation of process to determine the appropriateness of ex ante pricing, by the tax administrations.

It is emphasised in Action Plan 8-10, to permit resolution of cases of double taxation arising from the application of the approach for HTVI through access to the mutual agreement procedure under the applicable treaty. Accordingly, it is stated that guidance under this discussion draft ought to be read in conjunction with the framework of the commitment made in the Final BEPS Report for Action 14 'Making Dispute Resolution Mechanisms More Effective'.

Key takeaways

It is noteworthy that the guidance provided in the discussion draft may be relevant and practical for a matured tax jurisdiction which is capable of dealing with complex issues involving HTVIs and have reasonable trust of the taxpayer community, which may help in bridging the gap of information asymmetry.

However, emerging economies like India, where there are no clear regulations on pricing of related party transaction involving HTVIs, may adopt it as a reference point to introduce changes to its legislations for adopting global best practices, especially in order to avoid a double taxation scenario.



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