

Transfer Pricing of Intangibles

47th SGATAR Meeting

Wang Yi-Ru

Chinese Taipei

Date of Presentation: Day-11-2017



Agenda

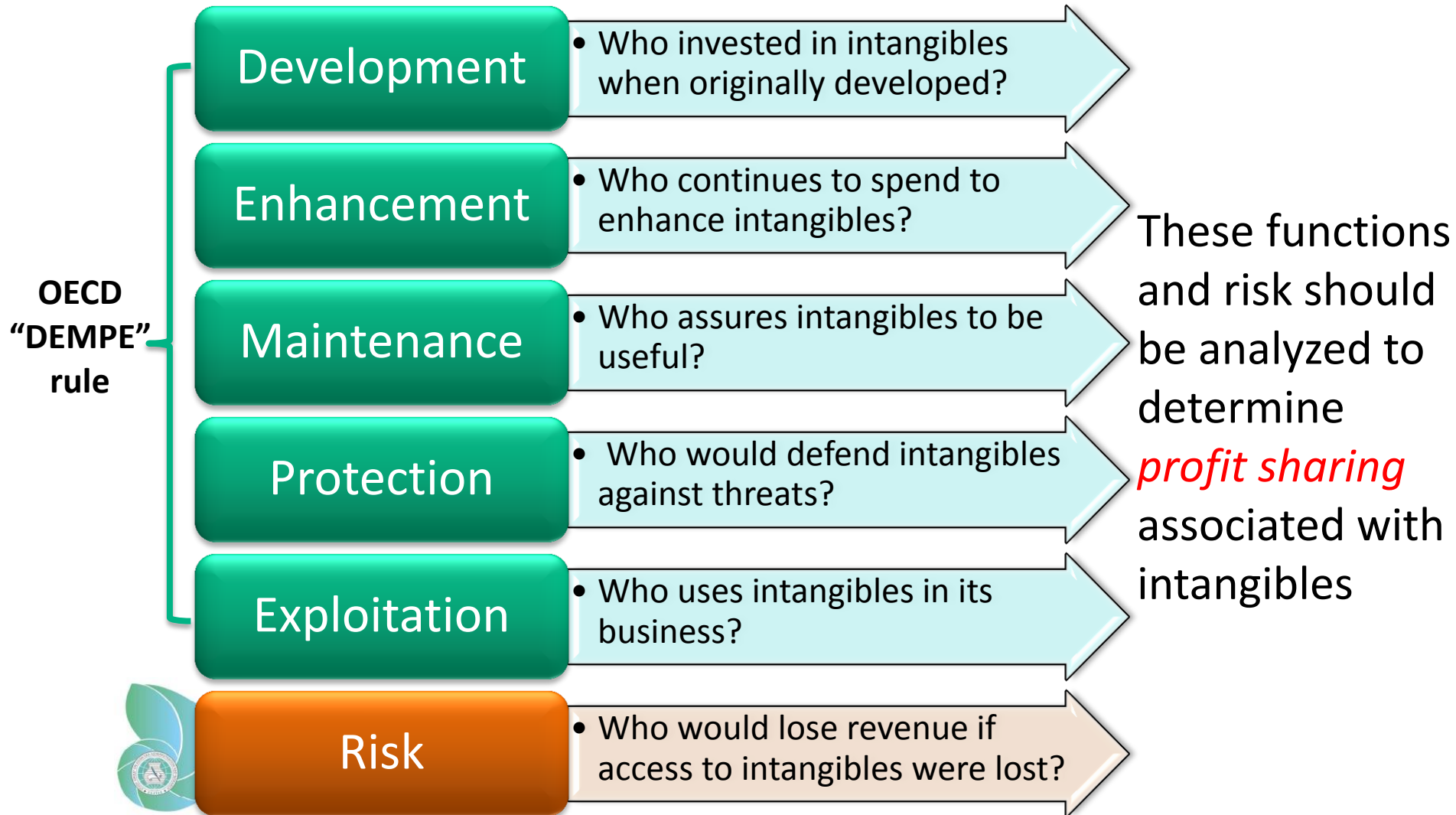
- ❑ Definition and Ownership of Intangibles
- ❑ Valuation Rules for Intangibles:
CUT, CPM ,& PSM
- ❑ Transfer Pricing Audit of Intangibles:
Documentary Submissions, Sanctions, & The Most Pressing Issues



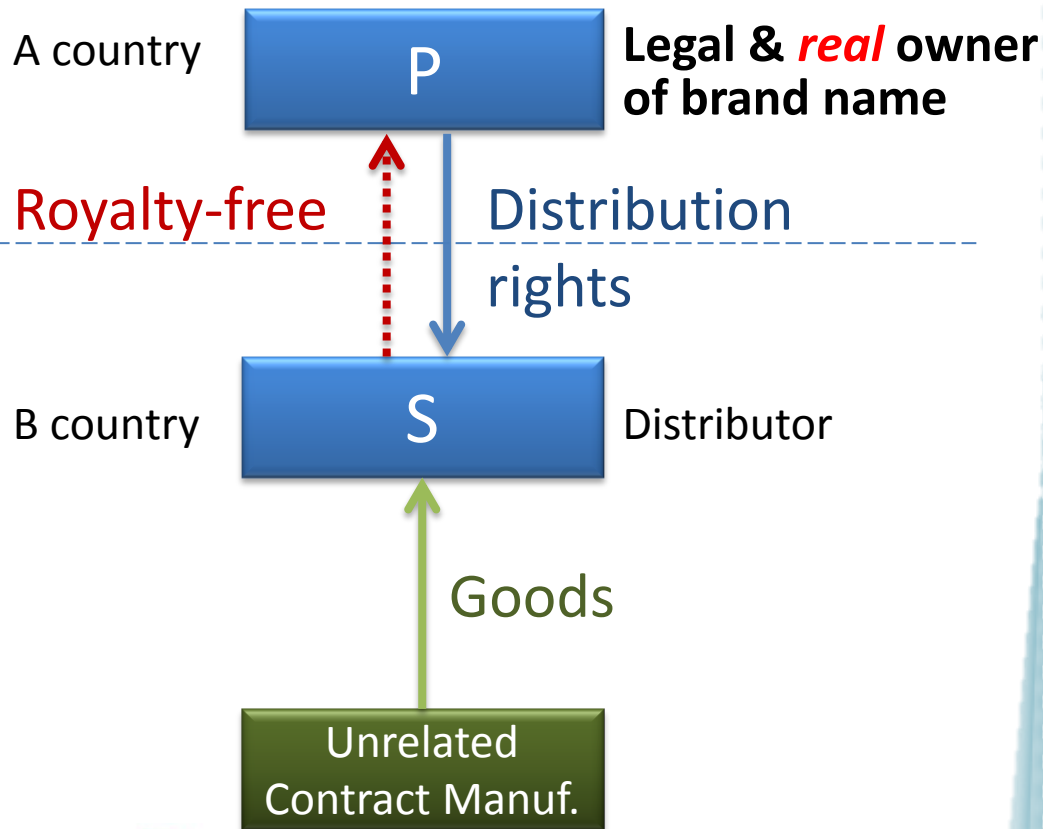
Definition of Intangibles

Items	Income Tax Act	TP Regulations
Listed intangibles	Business rights, trademarks, copyrights, patents and other franchises	Business rights, copyrights, patents, trademarks, enterprise name, brand name, design or model, plan, secret formula, or information concerning industrial, commercial, or scientific experience or proprietary knowledge, all franchises, online marketing, client data, and other rights that have property value
Legislative purposes	The correct value of intangibles and amortization expenses	The rational transfer price
Extent	Narrow	Wide

Ownership of Intangibles



Case for Marketing Intangibles



- TP Method: CPM
- PLI: ROS
- Tested party: S
- Comparables: routine distributors that own *no valuable intangibles*



Valuation Rules: CUT

- ❑ CUT is the specified method that directly values the transaction; valuation depends on finding **a comparable uncontrolled transaction between unrelated parties under comparable circumstances.**
- ❑ Due to the special nature of intangibles and lack of public data, it is **less likely that internal and external comparable data can be obtained.**



Valuation Rules: CUT

□ CUT comparability factors:

- Terms of the transfer
- Stage of development of the intangibles
- Rights to receive updates, revisions, or modifications
- Uniqueness of the assets and the period for which it remains unique
- Duration
- Any economic and product liability risks of the transferee
- Functions to be performed



Valuation Rules: CPM

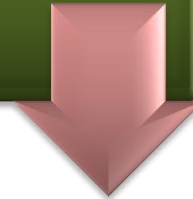
□ CPM is the most common method. Its steps:

- 1 • Select the tested parties and activities
- 2 • Select the comparables
- 3 • Select the profit level indicator
- 4 • Determine the average profit margin of the comparables
- 5 • Calculate the comparable operating profit and determine the Arm's-Length range
- 6 • If the operating profit falls outside the Arm's-Length range, the tested party shall be adjusted to the median of the operating profits of all the comparables.

Valuation Rules: PSM

□ Our PSM is the **residual profit split method**, relied upon when both parties own or contribute to the creation of unique, valuable intangibles. Its steps:

1. Allocate regular income based on regular contributions



2. Allocate residual profit in accordance with the contribution of intangible property

***Difficult step! Hard to find out the appropriate distribution factor**



Documentary Submissions

❑ Documents that should be prepared:

- A comprehensive business overview
- A description of organization structure
- Summaries of controlled transactions
- Transfer pricing report
- Other supporting documents: contract, transaction certificates, etc.

❑ Submissions deadline:



- Within 1 month after receipt of a notice
- 1 month extension period

Sanctions

- ❑ Fines of no more than **2 or 3 times the amount of the tax evaded** in the following situations:
 - Reported price is 2 times or more than the Arm's-Length price; or lower than 50% of the Arm's-Length price.
 - Increase in taxable income adjusted is more than 10% of the annual taxable income of the enterprise; and more than 3% of the annual net operating revenue.



Sanctions (Cont.)

- ❑ Fines of no more than **2 or 3 times the amount of the tax evaded** in the following situations:
 - An enterprise cannot produce a transfer pricing report, and no other documents support the transactions being Arm's-Length result.
 - Other de facto tax omissions or under-reporting situations are discovered by the tax collection authorities where the amount of evasion is significant.



The Most Pressing Issues

□ Evaluation Techniques (OECD BEPS Action Plan 8)

- Calculation of the discounted value of projected future income streams or cash flows derived from the exploitation of the intangibles.
- Requirements of this approach:
Defining realistic and reliable financial projections, growth rates, discount rates, the useful life of intangibles, and the tax effects of the transaction.



Thank You



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