

# Taxation and Pricing of Intangibles By Alan Ross

## Summary of Paper

This research paper, by Alan Ross, was commissioned by the Singapore Tax Academy and SMU Centre of Excellence for Taxation.

Alan was previously Head of Tax at PwC Singapore and held a number of leadership positions within PwC overseas prior to Singapore. He has over 30 years experience in International Tax and Transfer Pricing including major issues relating to the taxation of intangibles.

The paper first addresses the importance of intangibles in terms of their massive contribution to corporate values in recent years. The relative ease of migrating ownership of intangibles from one jurisdiction to another, possibly lower tax jurisdiction, highlights the concern of many tax authorities. These authorities naturally want their fair share of taxes from the profits generated by such important value drivers where these are wholly or partly situated in their respective jurisdictions. This also explains the significant focus on intangibles in the OECD's Base Erosion and Profit Shifting (BEPS) work. ***It should however be noted that this paper was issued shortly before the final BEPS papers were issued by the OECD in October 2015. While nothing fundamental should be changed as a result of the final OECD recommendations, the paper has not been updated for those.***

The paper focuses significantly on the issues raised by the BEPS project including addressing frameworks for analysing intangibles transactions, the importance of contractual terms and their consistency with actual conduct and functions and of course, the need to allocate intangible profits to those locations where the substantive value creating functions are undertaken. In this respect the so-called "DEMPE" functions are addressed (i.e. Development, Enhancement, Maintenance, Protection and Exploitation) and usefully illustrated by the author with practical real life examples detailing how the intangibles process can be mapped out to identify the truly important functions and risks, the range of values that might be attached to those and where they are carried out or in substance reside.

Methodologies for pricing various intangibles transactions are explored in some depth including the availability (or lack thereof) of good third party comparables and the usefulness and limitations of publicly available databases in searching for the same. Comparable Profits methods and Profit Split

methodologies are also discussed again noting the practical difficulties associated with applying such methods to unique intangibles.

The pricing methods are usefully linked by the author to various methods for valuing intangibles as these should clearly be consistent with the pricing of individual intangible transactions and vice versa. The valuations section covers cost based, market based and income-based approaches to valuations, forecasting issues and discounted cash flow models including the use of Capital Asset Pricing Models (CAPM). The paper also explores some of the difficulties in valuing early stage technologies and goes on to address more sophisticated approaches such as the use of Real Options and Game Theory.

A practical section linked to detailed country Appendices addresses how various Asian and Western countries presently approach certain intangible transactions including the sale or purchase of intangibles, licensing of intangibles and cost sharing. The section explains some of the barriers and uncertainty of tax treatment that often exists especially in developing nations.

The paper concludes with a brief commentary on so-called Patent Box regimes that have been introduced in a number of countries and discusses the proposed moderation to such regimes in the “Nexus” approach put forward by the OECD.

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