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DRAFT TECHNICAL ABSTRACT OF THE DELOITTE STUDY ON THE APPLICATION OF ECONOMIC VALUATION TECHNIQUES FOR DETERMINING TRANSFER PRICES

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Study on the Application of Economic Valuation Techniques for Determining Transfer Prices of Cross Border Transactions between Members of Multinational Enterprise Groups in the EU

Technical Abstract

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1. Premise and focus of the study

Over the recent decades and recent years, the business environment has been changing significantly, driven by the evolution of global markets, of international trade, as well as by rapid technological progress and the emergence of new business models and entirely new economic sectors. The business models of multinational companies have become more complex, with the companies' value chains becoming more integrated, making it more difficult to understand where the most value is created, whereas the volumes of intra-group cross border transactions have blossomed.

Recent years have been also characterized by an increased political attention on harmful tax competition and profit shifting, urging the governments to address aggressive tax planning and manipulation of prices with intra-group transactions whereby multinational enterprises try to minimize their tax liability by shifting capital and income from higher tax regimes to lower tax jurisdictions.[1] One of the active measures in this respect is the OECD proposed action plan against base erosion and profit shifting ("BEPS") to reinforce the current international tax rules and stabilize national tax bases. A specific part of the action plan (Action 8) focuses on changing the OECD transfer pricing guidelines ("TPG") and possibly the OECD Model Tax Convention to prevent BEPS when multinational groups move intangibles amongst the group members, in order to ensure that transfer pricing outcomes are aligned with value creation. A concrete implementation of Action 8 was the revision of Chapter VI of the TPG "Intangibles." Amongst the recommendations of the revised Chapter VI, there is a reference to economic valuation techniques based on the discounted value of projected income streams or cash flows derived from exploitation of the intangibles being valued, as "particularly useful" tools.

The purpose of the present report is to assist the European Commission to evaluate how valuation techniques can practically and most efficiently be used for transfer pricing purposes in the EU. This includes identifying advantages, obstacles and pitfalls in the practical applications of the economic valuation technique in the transfer pricing context. As such, the study focuses on the following key aspects:

[1] Commission Staff Working Document: Corporate Income Taxation in the European Union, SWD (2015) 121 final.

- Aspect 1 – An overview of the economic valuation techniques applied in the context of transfer pricing within the EU, analysing the strengths and weaknesses, opportunities and threats ("SWOT") and exploring and reviewing the different standards available both at European and international level, illustrated by examples and cases;
- Aspect 2 – Practical application of the valuation techniques in transfer pricing including identification of the various parameters under each of the building blocks (projections of future cash flows including growth rates, determining a discount rate, the useful life of intangibles and terminal values of the valuation techniques) and elaborating on the information, which is needed for determining the parameters of these building blocks;
- Aspect 3 – Identifying legislative measures implemented into domestic law of major non-EU States and exploring any potential changes to legislation/administrative guidance on transfer pricing within EU, as well as existing legal or administrative obstacles to the implementation of such changes in the specific MS; and
- Aspect 4 – Capacity building based on the situation non-EU States' tax administrations and estimating the costs to be expected for valuing a transfer or use of intangibles.

2. Work performed

The study was performed through the following steps:

- Desk research needed for providing a theoretical framework and specific topics that are covered by the study. These included the detailed research of the TPG, the US and German laws, overview of regulations of other countries, various valuation standards as well as extensive economic literature on the topic.
- Drafting of an extensive survey covering the topics listed above and other relating items necessary for the understanding of the topic;
- Interviews (face-to-face or via call) with Transfer Pricing and / or Corporate Finance valuation specialists from the 28 EU Member States and from EU's ten main trade partners;
- Analysis and interpretation of the answers from the abovementioned respondents, followed by the incorporation of the resulting information into the body of the report, accompanied by visual presentation of results where helpful;
- Extensive discussion between the transfer pricing and corporate finance experts in respect to the topics covered by the study;
- Drafting the overall report.

3. Limitations

The main goal of the study was to understand the way and to what extent the economic valuation methods and techniques are currently used for transfer pricing valuations. In this respect, at least in the overview of the practical experience, we did not focus on or explored fully the general valuation practice in respect of valuation for other purposes.

Related to the above, we did not address directly purchases of entire businesses or valuation of the shares in companies, as they generally do not qualify as a transaction from the transfer pricing perspective. In our experience, a valuation of shares is rarely performed or analysed by transfer pricing specialists and / or performed in line with the TPG and the local transfer pricing rules or regulations.

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However, to the extent that valuations of intangibles from transfer pricing purposes were combined with valuations of a business activity, our study has covered these aspects.

As with any research project, there are practical limitations regarding data collection. As agreed in our contract, our key data / information collection tools were desk research by the core team and the completion of an extensive survey by Deloitte transfer pricing and / or valuation practitioners. In the context of the survey, Deloitte practitioners were asked to comment not only on their direct experience, but also on any other relevant experiences they may be aware of in their respective countries, with the aim of reducing and eliminating (to the extent this is possible / practical) potential biases related to specific experience of one or several persons.

4. Differences in general approach and standard of value

Our report first investigated the background for performing a valuation for transfer pricing purposes as opposed to a valuation exercise for other purposes. In this respect, we especially focused on the following aspects investigating how they may impact valuation approaches and the types of the results achieved:

(1) Purpose of valuation and the main stakeholders of the valuation exercise

(2) Standards and concepts of value governing the specialist performing valuation.

(3) Definition and scope of intangibles for a valuation and, especially treatment of controversial items such as workforce, goodwill, synergies and location savings.

We investigated the effect that these factors may have on the approach to the valuation and on the types of the results achieved, both theoretically (with the help of the relevant literature) and in practice.

The study has confirmed that these factors may already have a significant effect on the practical outcome. If valuations for transfer pricing as opposed to other purposes valuations aim both at determining a market value, they have key differences that can be summarized as follows:

- A first difference lies in the purpose of the valuation. For transfer pricing purposes, the valuation is performed, evidently, to price a transaction between related parties. That would usually not be the case for other valuations.
- A second difference lies in the stakes of the valuation. For transfer pricing purposes, the stakes are basically a differential in tax rates (both sides of the transaction) applied on transferred asset. That impact can possibly even ben recouped by claiming double taxation relief. For other purposes, the stakes are the full value of the transferred asset.
- A third difference lies in the perspective of the valuation. For transfer pricing purposes, more often than not – and under BEPS it becomes a clear trend – valuation will / must be double-sided. Valuators have actually also (theoretically) access to data on both sides. For other purposes, it is often one-sided, where the valuator will have access to data on only one side of the transaction.
- A fourth difference lies in the evidence valuators need to gather. For transfer pricing purposes, evidence that all items entering a valuation formula are, at least to some extent, market-driven may have to be produced. For other purposes, only the sponsor of the valuation needs to approve the values.
- Linked to the previous two aspects, transfer pricing analysis is always based on the detailed analysis of facts and circumstances, as well as functional and risk profile of the parties relevant to transaction. In practice, the analysis is documented in a special transfer pricing report documenting, amongst other, the full business model, value change, the extent of business transformation and the economic functions and risks of the parties. Considering and accounting for "before" and "after" business circumstances in the performed valuation are of a higher importance for a transfer pricing specialist rather than to a general valuation expert.

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- A sixth difference lies in the standards that are applied. For transfer pricing purposes, it will usually be the OECD TPG, or any other local / regional transfer pricing regulation. For other purposes, while there is a broad agreement between valuators on the key principles and methods, the specific standards are only relevant in certain contexts and geographical areas.
- A seventh difference, lies in the definition of intangibles. The definition appears to be broader in transfer pricing; an item may be considered an intangible from the transfer pricing perspective even if (1) it does not have legal protection or (2) is not separately transferable,[2] whereas fulfilling one of these two criteria is required in order to value intangible assets for accounting purposes (under the IFRS and the US GAAP).
- An eighth difference lies in the scope of the valuation. "Aggregation" or "bundling" of intangibles is common practice in transfer pricing, but is less common in other fields. The difference also lies in the approach to special items, such as workforce, location savings, business synergies. Whereas the TPG approach the latter items as a "comparability factor" to account for when performing a transfer pricing analysis, the treatment of these items may be different in the general valuation practice. One of the examples of such difference is the workforce, which is valued separately in valuations for purposes other than transfer pricing. With exception of very few countries, we have generally found that the surveyed respondents confirmed that these three factors are considered to be important to consider in valuation but, however, are not valued as standalone intangible assets in the valuations for transfer pricing purposes.
- As a ninth aspect, there are potential theoretical and / or practical differences between the concept / basis of value used in valuations in general (fair value, market value, fair / open market value) and the arm's length price concept used in transfer pricing. Whereas the fair market value is based, by definition, on hypothetical market (being main or advantageous market), the arm's length principle is applied with the conditions of comparability standard, requiring to consider all factors surrounding the transaction and the parties to transaction that may impact the price. This means that entity-specific and transaction-specific economic factors as economies of scale, relative bargaining powers, legal rights, location savings, synergies, may be taken into account differently by a transfer pricing economist vis-à-vis general valuation specialist.
- Finally, the concept and meaning of the goodwill is also different in transfer pricing as explicitly acknowledged by the TPG. Goodwill in transfer pricing is frequently associated with the reputation for supplying high-value products or, moreover, frequently not considered to be a stand-alone asset whereas a frequently observed definition of goodwill in general valuations implies a difference between an aggregate value of business and the sum of the values of all separately identifiable tangible and intangible assets.

5. Experience with valuations used for transfer pricing purposes

In the terms of reference provided, the EU Commission states that "only a few member states have already gained experience in" using economic valuation techniques. The survey has investigated what kind of experience is observed in respect to valuations of intangibles for transfer pricing purposes in the member states. Besides a useful general perspective on the state of play, understanding the experience of the member states may be of high importance for attributing a proper significance to their statements in respect to appropriateness of techniques and methods and practice in respect to the building blocks.

It was observed that the practice of intangibles valuation for the purposes of transfer pricing is relatively underdeveloped in many of the EU member states, as can be seen in the figure below illustrating the state of play. Only 13 countries out of 28 member states confirmed relatively significant experience with such

[2] OECD, *Aligning transfer pricing outcomes with value creation*, *Actions 8-10: 2015 Final reports*, para. 6.8

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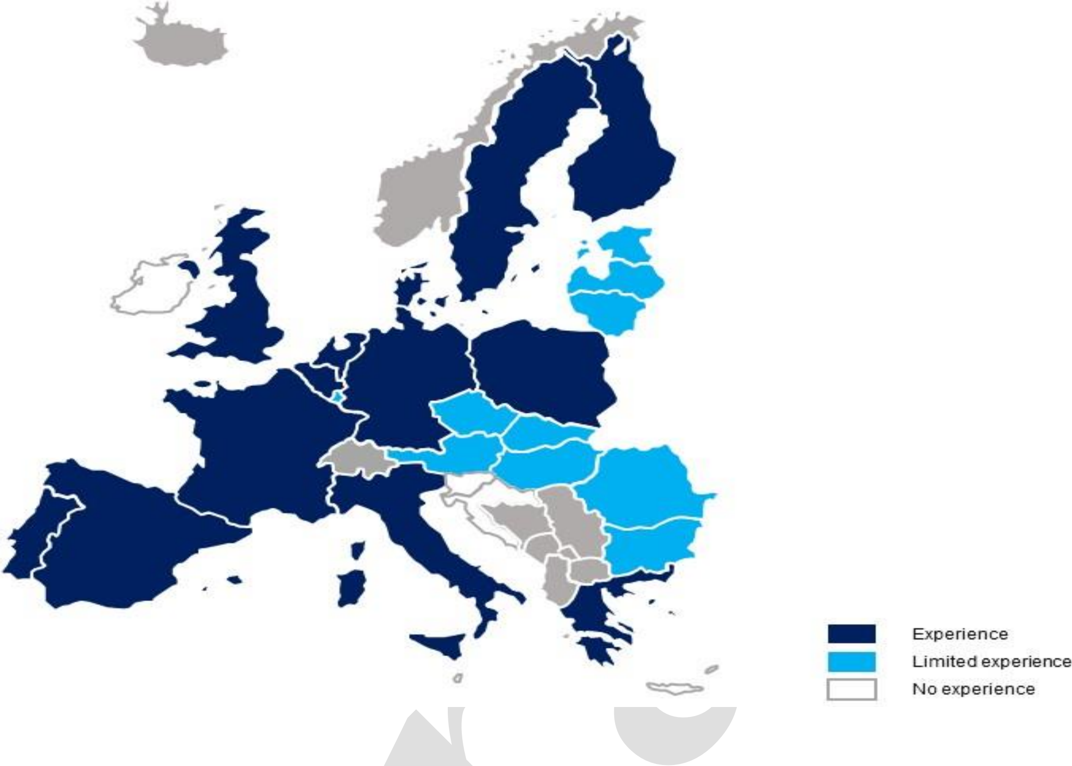
valuations, ten countries recorded limited or extremely limited experience and five countries – no such experience at all.

Figure 1. State of play – Experience in IP valuation for transfer pricing purposes



We also surveyed nine main trade partners in this respect, namely Australia, Brazil Canada, China, India, Japan, Norway, South Korea, Switzerland and the United States. It was observed that that the practice of IP valuation for the purposes of transfer pricing is relatively developed in the main trade partners of the EU. Brazil did not record any experience in this respect due to a very particular transfer pricing legislature. China and Japan noted somewhat limited experience in respect to the valuations for the purposes of IP transfer and also Korea marked its experience as very limited. The figure below sets out the state of the play amongst main trade partners.

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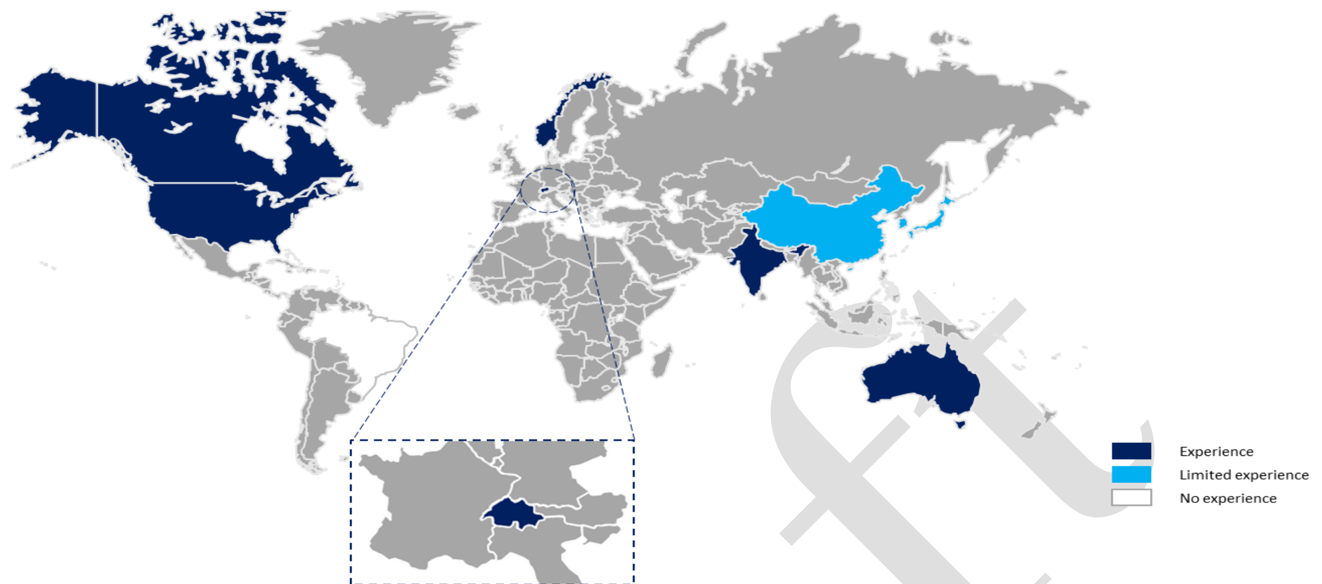
Figure 2. State of play – Experience in IP valuation for transfer pricing purposes – main trade partners



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Out of the countries that did register some experience with valuations of IP for transfer pricing purposes, it was found that the degree of experience is uneven in respect to the different types of intangibles. Through the surveys it was determined that both in the EU member states as well as in the trade partners' practice, most valued are marketing-based intangibles followed by technology-based ones. The third most valued was customer-related IP and the least valued type of intangibles was contract-related.

6. Aspect 1 – Economic valuation techniques applied in the context of TP

In respect to Aspect 1, we have investigated the use of various valuation methodologies for transfer pricing. The study also provided a SWOT analysis of these methodologies, in theory and based on the survey. Finally, we also indicated potential solutions that address some of the shortcomings of valuation methodologies when used in a transfer pricing context.

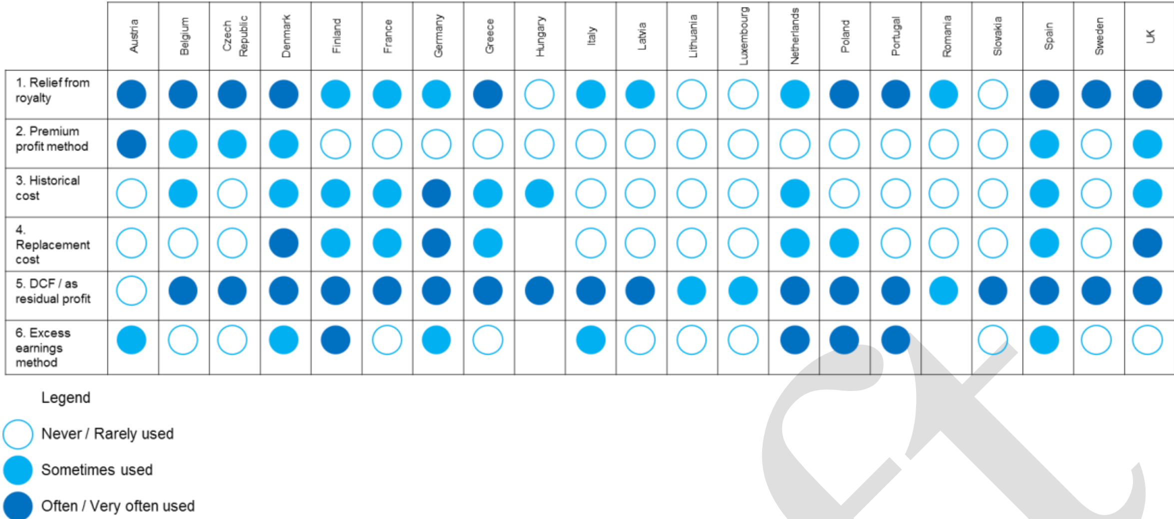
As a related topic, the valuation standards are addressed, especially focusing on the use of these standards in transfer pricing valuations.

6.1. Methods and their strengths and weaknesses

Valuation methods for transfer pricing purposes

Under the general valuation approaches (market, income and cost-based), there are specific valuation techniques. For the purposes of the study, the following main techniques presented in the table below have been defined (and presented for the review by respondents) as potential methods for valuing intangibles for transfer pricing purposes. The ranking of these methods among the EU member states has also been illustrated.

Figure 3. Usage of main IP valuation methods for transfer pricing purposes



It was observed that the most used methods among the EU member are the DCF / residual profit method and the relief from royalty. The most important factor noted by respondents in making the decision regarding the method applied for valuing intangibles is the availability of data that allows to use a certain methodology as most reliable or appropriate.

SWOT analysis

In order to look at the methods in more depth, the main valuation methods identified for valuation of IP for transfer pricing purposes were reviewed according to the following aspects:

(1) Economic Relevance – this aspect measures to what degree the methodology reflects the economic value of the intangible studied;

(2) Objectivity – to what degree the main parameters can be objectivized based on the comparable or taxpayer-specific data. A higher rating on this criterion may reflect a more robust valuation and potentially diminish the range of the values obtained through application of the methodology;

(3) Relative ease of use – this aspect attempts to measure how simple is the methodology to understand and adopt for use by a valuator (transfer pricing practitioner who acts as a valuator) and, correspondingly, to review / assess by tax administration;

(4) Appropriate benchmarks – in this aspect, we measured to what degree (appropriate) market benchmarks are available. For instance, not all intangibles may have comparables – it is not possible to find a comparable to “Coca Cola” brand and trademark. Similarly, customer relationships in a particular business or industry and territory may not have any “comparables”;

(5) Market-connection – this measures to what degree the value obtained is directly driven by the market (i.e. to what degree the methodology measures the price directly based on market price rather than indirectly); and

(6) Extent of data required – this aspect measures the amount and extent of data required for applying the methodology.

It is important to note that there may be a degree of interdependency between some of these aspects.

The analysis resulted in the following analysis with regards to the above aspects, with:

- Green colour marking the strongest methods in respect to the criterion.

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- Red colour marking the weakest methods.
- Yellow colour marking the methods with a certain degree of strengths and weaknesses.

Figure 4. SWOT analysis

	Economic relevance	Objectivity	Relative ease of use	Appropriate benchmarks	Market connection	Extent of data required
1. Relief from royalty	Green	Yellow	Green	Red	Green	Green
2. Premium profit method	Green	Yellow	Yellow	Red	Green	Yellow
3. Historical cost	Red	Green	Green	Green	Red	Yellow
4. Replacement cost	Yellow	Yellow	Green	Yellow	Yellow	Yellow
5. DCF / as residual profit	Green	Red	Red	Green	Red	Red
6. Excess earnings method	Green	Red	Red	Green	Red	Red

The SWOT analysis identified that there are potential weaknesses for each method and each of them should be used depending on facts and circumstances. Ideally, the right method to use is the one that give the lowest probability of a bias or error, subject to practical considerations (regarding data availability, timing and budget.)

Potential remedies to weaknesses of income-based methods

One of the potential approaches to address the shortcomings of specific valuation methods could be the use of more than one method, or alternatively, a valuation from two parties' perspective. In some cases, these could be equivalent measures, since looking at the value from another party's perspective may involve a different method and vice versa.

For dealing with intangibles whose valuation is highly uncertain at the moment of the transaction, a remedy may be the use of price adjustment clauses. Although most of the EU member states do not use these clauses in practice, the vast majority of the respondents seems to be almost uniform in attributing some or large importance to them.

6.2. Valuation standards and their use in valuations for transfer pricing purposes

General valuation standards

Valuations of both businesses and intangible assets are in general performed for a wide variety of purposes, including M&A, disputes and litigation, financial reporting, non-transfer pricing tax purposes, other statutory regulations, etc. Practical valuation approaches have often emerged on a country by country basis, or depending on the specific valuation context. As a result, while there is broad agreement between valuators on many key principles and approaches / methods of valuation, specific standards have been relatively slow to emerge and are still relevant only in certain contexts and geographic areas. Such key valuation standards are listed in the body of the report, and generally cover technical valuation issues, including selection of valuation methodology and valuation inputs / building blocks, but also aspects related to the valuation process, valuator qualifications and ethical / independence issues. The limited applicability of these standards contrasts with transfer pricing valuation guidance, which, as it is issued by the OECD, has a more uniform application in practice across OECD members and all countries that are "observers" to the OECD. The reasons seems to be the only a few countries would enact own regulations on transfer pricing and intangible, but would rather defer to the OECD guidance.

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Use of valuation standards in valuations for transfer pricing purposes

In the member states, only two countries mention that, in case of the valuation for transfer pricing purposes, it is compulsory to refer to certain valuation standards. These two are Germany and Austria, where, in both cases, there are special valuation standards which are referred to by the transfer pricing regulations. For instance, in Germany, the Ordinance in respect to cross-border transfers of business functions refers to the IDW S 5, Principles for the Valuation of Intangible Assets. All other countries confirm that the only standard applicable to valuations for transfer pricing purposes are the OECD TPG and the local laws and regulations that are based on the OECD guidelines.[3]

To the degree that the transfer pricing experts refer to the help of general valuation experts outside of transfer pricing practice, the local valuation standards are used. However, only six countries note the practice of such standards, with three of the six noting that these are international valuation standards.

7. Aspect 2 – Practical application of economic valuation methods

Under Aspect 2, we explored the impact of the purpose of the valuation (being transfer pricing) and the arm's length standard criterion on the assumptions and parametrization made in the course of a valuation exercise.

First, we focused on exploring the main principles of the five main building blocks, being financial projections, royalties (for relief from royalty method), routine return (for discounted profit / residual profit method), discount rates and useful life of intangibles. Desk research in respect to both valuation standards, the TPG, and literature on the discussion, as well as comparing the practices of transfer pricing experts and valuation experts have identified conceptual differences in the parameters. Next, we have supported the theoretical considerations with the practical observations from surveying 28 member states in respect to their experience with valuations for transfer pricing purposes. The noted differences included the following:

1) Financial projections – we observe that, financial projections used in any valuation merit a high degree of scrutiny. The most practiced approach to data scrutiny is checking the reasonability of the forecasts against the past performance, with checking for outliers and comparison with the industry / competitors being also common measures. In terms of the level of income or profit to consider, there is a high degree of judgement, independent of the valuation objective. Experts in different countries divide between the use of the free cash flows or operating profit. There is also a difference in opinions in respect to whether the obtained value should be, in practice, a pre-tax or post-tax value.

2) Royalty – the approach for benchmarking royalty appears to be governed by the principles of comparability and arm's length character in all types of valuations. In transfer pricing, however, the governing principles are fully documented in the TPG (as the requirements of the CUP method). This makes a royalty search a more detailed, better documented and more rigorous exercise in studies for transfer pricing rather than other purposes.

   In respect to this parameter, transfer pricing specialists face strict comparability requirements of the CUP method. Finding a pragmatic solution often means disregarding or downplaying the differences (in characteristics of intangibles analysed and potential comparable arrangements) and thus making a parameterization of the royalty vulnerable from perspective of potential challenges from tax administration.

3) Routine return – similar to the benchmarking of the royalty, although the general principles behind finding an adequate routine return are the same in several types of valuations, the level of detail of the process of finding and documenting routine returns is greater in transfer pricing. This parameter is

[3] Placeholder to investigate Denmark. The Danish TP guidelines talk about three valuation methods, the extent of discussion needs to be reviewed by Deloitte.

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often a subject of a separate transfer pricing analysis governed by the principles of the TNMM of the TPG. Differences in routine return parameterization thus may involve in practice different comparables and different norms in considering multiple year data and business cycles.

4) Discount rate – in contrast to the royalty and routine returns, the approach of transfer pricing to discount rates may be in practice not as well established, both in theory and in practice. The transfer pricing specialists often refer to valuation experts in respect to this building block, or use not as well founded estimates as industry-wide rates or taxpayer's provided rates.

5) Useful life and terminal value – both in valuations for transfer pricing and other purposes the useful life of intangible deserves and gets appropriate attention. It appears however, that the estimate of useful life in an exercise for transfer pricing purpose may be different than if the study was developed for other purposes. The authors of the present study hypothesize that the difference may stem from the accent on the parties of the transaction that is present in the transfer pricing exercise (to comply with arm's length standard and consider options realistically available to the parties), rather than hypothetical market assumption taken in general valuation practice (to obtain fair market value).

The observations in respect to the main five parameters in the member states are consistent with observations of the main nine trade partners.

8. Aspect 3 – Legislative measures

8.1. The US regulations

The US transfer pricing regulations contain a special section, Section 7 to provide a legal framework to value "platform contribution", any resource, capability or right that a controlled participant has developed, maintained or acquired externally to the intangible development activity. This section is in addition to Section 4 covering the methods to determine arm's length amounts in a controlled transfer of intangible property other than cost contribution arrangements.

The choice of the most appropriate methodology must be subject to the "best method rule", a condition that the arm's length result should be determined under the method that, given facts and circumstances, provides the most reliable measure of an arm's length result, based on two primary factors, namely the degree of comparability between the controlled transaction (or taxpayer) and any uncontrolled comparables, and the data and assumptions used in the analysis.[4]

Methodologies

It can be observed that the framework of methodologies encountered in the US regulations is largely consistent to practices in Europe. It is important though to note that the cost-based methodologies are not amongst the methods for valuation of intangibles in the US regulations. It is not the methods *per se* but the additional guidance and amount of examples in respect to the application of the methods that provide additional value to the US practitioner in comparison with the guidelines provided in the TPG.

Financial projections

The US law provides similar guidance in respect to the use of the financial projections by valuator as the OECD's TPG, putting emphasis on the specific facts and circumstances in light of the completeness and accuracy of the underlying data, and on the reliability of assumptions and sensitivity of results. In that sense, projections prepared for non-tax purposes are deemed to be more reliable than projections prepared for tax purposes.

[4] Section 1.482-1(c)

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Discount rate

The US law indicates that the discount rate to be used should be the one that reflects most reliably the market-related risks of the activities and transactions. The US regulations point to the "realistic alternatives" that should be considered in the analysis of the discount rate (involving different risk exposure) and also between forms of payment.

For certain activities or transactions, implied discount rates may exist; however, the facts and circumstances of each case must be analysed in detail and evidence must be provided on the reliability of such implied rate. In general, the discount rates obtained from the market are post-tax discount rates, resulting in the application of post-tax discount rates to post-tax income; in some circumstances though, calculation of the pre-tax income may be sufficient.

Practical examples

It seems that the US regulations are rather unique in respect to the number and detail of the quantitative examples they provide. The examples prove to help to understand the methodologies in practical terms and the steps behind calculations.

8.2. German regulations

The main guidance in respect to valuations for transfer pricing purposes is contained in so-called ordinance (*Rechtsverordnungen*) specifying further details on the transfer pricing rules on cross-border transfer of functions (*Funktionsverlagerungsverordung or "*FVerlV*")*. This ordinance provides additional guidance on main transfer pricing principles contained in German Foreign Tax Act.

In respect to the purpose of the present study, a few aspects of the German regulations are especially important as a valuable example in respect to the legislative measures. These aspects are addressed below.

Two-sided approach

According to the FVerlV, in the absence of the market comparables (to the transferred functions), a hypothetical arm's length test should be applied. By the virtue of its construction, the hypothetical arm's length test is a two-sided approach which consists of determining the value from perspective of the "imaginary prudent and conscientious managing directors" of both transferor and transferee companies. The value of the "transfer package" result from the profit potential that arise from the change (usually, a reduction) of the capitalized profits of the transferor, and the increase of in the present value of the income of the "transferee – these form the basis of the lower and higher values, respectively, of the transfer package.[5] The ordinance notes that any valuation method can be used for determining the value at both sides of the transaction, referring to the valuation standards IDW S 5, "Principles for the valuation of intangible Assets."

Treatment of synergies and location savings

The German rules outline their position on treatment of synergies and location savings. FVerlV explicitly states that the profit / income forecast used in the valuation should contain all advantages or disadvantages of the relevant locations and the synergy effects of all enterprises involved. In this respect, it does not matter that much which enterprise caused the development of these (dis)advantages; however it matters to what extent these should be used by either party in the fictitious price negotiations.

[5] FVerlV, 2.3.2.1, para 91/

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<u>Discount rate</u>

It is important that the German ordinance explicitly mentions that the discount rates should reflect the actual risk profile of the function. In this respect the discount rate should include "risk-adequate" premium. Although the FVerlV does not explain how discount rate is established in practice, such guidance is provided by the valuation standards IDW S 5 referred to by the FVerlV. The latter explain the concept of the WACC which should be a "starting point" for discount rate determination, and the related concepts of return on equity and cost of debt.

9. Aspect 4 – Capacity building in tax administrations

It is observed that in the EU, only five out of 28 member states' countries noted the presence of sufficient transfer pricing resources in their country's tax administration. However, even these countries (besides one) note that these specialists are either in insufficient numbers or lacking expertise and experience precisely in valuations in the transfer pricing context. Eleven countries note that the taxpayers (multinationals) sometimes have internal resources to perform valuation for transfer pricing purposes with ten countries noting that these resources are very rare. Only seven countries noted that the taxpayer would attempt at least sometimes to perform a valuation study internally, however, in this cases it is expected that they would request an advisor to review such a study.

Amongst surveyed trade partners, only two countries mentioned sufficient resources, with others noting insufficiency, either in the number of specialists at tax administration or their level of familiarity with the economic valuations. The similar situation is at the multinationals in trade partners' (with only four countries noting that such specialists are sometimes present and others commenting that this happens rarely or never).

Thus, it seems that the problem of insufficient resources is present to more or less equal degree in the EU member states and among main trade partners.

10. Recommendations for possible policy actions

[Preliminary – For Discussion Purposes Only]

10.1. Understanding general background for a valuation

It is important to acknowledge and understand that the transfer pricing discipline is based on the detailed analysis of facts and circumstances, as well as functional and risk profile of the parties relevant to transaction. In practice, the analysis is documented in a special transfer pricing report documenting, amongst other, the full business model, value change, the extent of business transformation and the economic functions and risks of the parties. Considering "before" and "after" business circumstances of the analysed transaction are of a higher importance for a transfer pricing specialist rather than to a general valuation expert.

Further, the standard of value for transfer pricing, being the arm's length standard, warrants certain differences in a valuation for transfer pricing purposes. Amongst other, these differences include a requirement to consider the perspectives of both parties of the transaction in the analysis. Such stance of the two-sided approach is typically absent from a valuation from other purpose where a valuator presents only one side of the transaction be it a buyer or a seller.

It is further important to acknowledge and understand that the stakeholders, readers, and stakes /risks are considerably different depending on the purpose of the valuation (*cfa* Section 4 of the present document).

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10.2. Aspect 1 – General valuation techniques

The principles of the valuation models and techniques remain similar independent of the valuation purpose and context. Based on the general background, and the personal judgement, the choice of the final methodology may be different.

It is important to understand the methodologies and the amount of the assumptions and building blocks in each of them in order to select the most appropriate methodology; in fact, such an understanding is a key factor to defend the valuation successfully from the transfer pricing perspective.

10.3. Aspect 2 – Building blocks

Care should be given to the parametrization of the valuation model including each of the parameters. From a transfer pricing perspective, a proper justification is needed to defend all the parameters. This matters even more considering that the valuation may be challenged by a tax administration a few years after the intercompany transfer took place. In this respect, good practices exist (in respect to routine return, royalties, verification of financial data and proper discount rate studies) and should be further promulgated amongst transfer pricing practitioners.

10.4. Aspect 3 – Legislative measures

The transfer pricing laws in the US and Germany are a useful starting point in terms of extent of guidance they provide on the choice and application of valuation methodologies.

In this respect, the recommendation is to develop more guidance in respect to the building blocks and factors to consider, together with the practical examples on building a full valuation including the use of the financial data and parameterization.

10.5. Aspect 4 – Resources

More resources are needed to promulgate a correct understanding and use of economic valuation techniques. This applies both to the number of the specialists at tax authorities as well as their skill level in respect to valuations of intangibles for transfer pricing purposes.

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