

TRANSFER PRICING OF INTANGIBLES IN A DIGITAL CONTEXT: AN ISSUE FOR THE EU AND THE OECD

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Introduction

Transfer pricing refers to the prices charged when affiliate companies trade with one another. Since such transactions do not occur in the open market, integrated enterprises are able to set their internal prices. While transfer pricing has gained much notoriety, it is, in itself, not illegal. Transfer pricing becomes illegal when it leads to mispricing or else called transfer pricing manipulation. Mispricing occurs when the price charged for a good or a service being sold by one company to another company, member of the same group, is not comparable to the price that would be charged if this second entity was unrelated. In order to reassure that intra-group transactions do not lead to transfer pricing manipulation, the Organisation for Economic Co-operation and Development (OECD) provided a set of transfer pricing rules. These rules include the transfer pricing methods, which aim to approximate a proper remuneration for the intra-group transactions comparable to the remuneration that would be provided, if the other party of the transaction was an unrelated company.

Nowadays transfer pricing is one of the major problems of international taxation not only as far as the conventional economy is concerned, but also for the new type of economy that arose during the last few years: the digital economy. This new economy is best defined as ‘an umbrella term used to describe markets that focus on digital technologies’.¹ The digital economy has significantly affected all

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¹ OECD, ‘Hearings The Digital Economy’ (Unclassified DAF/COMP(2012)22, 07 February 2013) 5 <<http://www.oecd.org/daf/competition/The-Digital-Economy-2012.pdf>> accessed 19 April 2016.

business sectors and some of the existing companies in order to cope with the technological advances included digital business models in their operations. At the same time, a significant number of new companies emerged and took advantage of the unique opportunities that this new economy offered. Soon enough, it became obvious that the digital economy should be regarded as a whole new industry; an industry that impacted significantly on world trade.

In this context, intra-group trade has continued to be a significant part of the business operations of multinational enterprises (MNEs). Through transfer pricing, digital MNEs are able to transfer functions, assets and risks to low or no tax jurisdictions and, thus, erode the tax base of the country in which they operate. Intangible assets, in particular, have become very important for transfer pricing purposes in the context of this new economy. Such assets should be regarded as valuable non-physical assets, the exploitation of which raises the revenue of a company and, thus, their transfer from one company to another has tax implications.

The technique of transferring intangible assets to low or no tax jurisdictions has become a widespread practice of MNEs around the globe, followed by digital giants such as Amazon and Apple. Due to their effective tax arrangements (through which such companies can evade significant amount of taxes) Amazon and Apple have not only generated a public outcry during the last few years, but also became a focal point of investigation for the European Commission (the Commission). While state aid was the overriding purpose of the Commission's investigations, it was also found that these companies' tax deals with Luxembourg and Ireland respectively breached the current transfer pricing rules. These investigations are of particular interest for this paper because they both involve digital MNEs which are engaged in transfer pricing of intangible assets.

The inexorable reliance on the digital economy has attracted the attention of the Commission and of the OECD. To date, it has been stressed that the growth of intra-group trade, the new global business models that have arisen, as well as the service element of the economy enabled MNEs to adopt aggressive tax strategies and, thus, resulted in a huge incidence of tax avoidance.² In this context, the current transfer pricing rules were found to be inefficient. Therefore, both the OECD and the Commission took the view that these rules needed to be reviewed

² OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing 2013) 7-8 <<http://dx.doi.org/10.1787/9789264202719-en>> accessed 19 April 2016.

in order to accommodate, amongst others, the significant role of intangible assets for digital environments.³

However, the work done so far by the above organisations regarding the digital economy has not analysed the application of the current transfer pricing methods to intra-group transfers of intangibles within digital MNEs. This lack of analysis ensures that transfer pricing is a justified area of research. Accordingly, the purpose of this paper is to evaluate the application of the transfer pricing methods regarding transfer pricing of intangible assets in the digital economy, based on the OECD transfer pricing framework. For this purpose, the work of the OECD and the Commission regarding the digital economy will be assessed. Moreover, an analysis of the Commission's investigations regarding Amazon and Apple will be carried through, along with a theoretical evaluation of the OECD-recognised transfer pricing methods. An evaluation of the Commission's view on the transfer pricing methods that were suggested in these cases is very much the focus of this work, rather than a comment on the *raison d'être* of these investigations. In addition, the current work of the OECD in the Base Erosion and Profits Shifting (BEPS) project regarding intangibles and the use of the profit split method will be scrutinised.

In order to achieve its aim this paper is divided into four chapters. Chapter I examines the digital economy, as a new area of business operations. Chapter II explains briefly the OECD-recognised transfer pricing methods and underlines the significance of intangibles for transfer pricing purposes in the digital economy. The Commission's investigations are assessed in Chapter III, as they are indicative of the tax structure of a typical digital MNE. Finally, in Chapter IV, a theoretical assessment of the current transfer pricing methods based on a method-by-method analysis is provided.

I. The Digital Economy

The digital economy came to the forefront of the agenda of the OECD and the Commission in 2013, in order to follow the recent technological innovations, which dramatically altered the current manner of doing business. However, about fifteen years before the works of these organisations, electronic commerce (e-commerce), a business model of the digital economy, had already triggered

³ Commission Expert Group on Taxation of the Digital Economy, 'Report' (European Union 2014) 46 < http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf > accessed 19 April 2016; OECD, *Addressing the Tax Challenges of the Digital Economy* (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing 2014) 15 < <http://dx.doi.org/10.1787/9789264218789-en> > accessed 19 April 2016.

discussions regarding its taxation. In 1998 the Committee on Fiscal Affairs of the OECD stressed that the taxation principles that apply to traditional commerce (ie neutrality, efficiency, certainty and simplicity, effectiveness and fairness, and flexibility) should apply to e-commerce as well.⁴ This statement was the first acknowledgment that there exists an analogy between this new form of trade and the traditional one.

As the digital economy was constantly spreading, the OECD in Action Plan 1 of its BEPS project analysed the digital economy and endeavoured to identify its characteristics, the reasons behind its growth and its taxation framework. It defined this new economy as ‘the result of a transformative process brought by information and communication technology (ICT)’.⁵ The Commission in its own Report regarding the digital economy (which basically reached the same results as Action Plan 1) gave a similar definition to this new economy, namely ‘the result of the transformational effects of new General Purpose Technologies (GPT) in the fields of information and communication’.⁶ These two definitions became a starting point to discuss the digital economy.

A. The Emergence of new Business Models and the E-Commerce

The digital economy fundamentally altered the way that business is carried out. According to the OECD, quite a few new business models arose, many of which may ‘have parallels in traditional business.’⁷ The cloud computing for instance is definitely a new model, while other digital business models are rather new venues of operations, through which traditional business functions can be carried on. An example of such a new venue can be found in the sector of advertising, where the idea of targeting customers and delivering them marketing messages existed many years before the online advertising. Through the latter though, the Internet is being used as a mean of promoting goods and services⁸ and, thus, companies are able to advertise products ‘at substantially greater scale and over longer distances than was previously possible’.⁹

4 Committee on Fiscal Affairs, ‘Electronic Commerce: Taxation Framework Conditions’ (OECD Ministerial Conference “A Borderless World: Realising the Potential of Electronic Commerce”, 08 October 1998) 3, 4

<<http://www.oecd.org/tax/consumption/1923256.pdf>> accessed 19 April 2016.

5 OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 11.

6 Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 11.

7 OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 73.

8 *ibid* 79.

9 *ibid* 73.

In contrast to the new business models and the new venues of operations that arose, e-commerce existed a long time before the conception of the term ‘digital economy’. E-commerce was pioneered by Michael Aldrich in 1979 and marketed in 1980, but at that time it was not financially viable for business-to-consumer transactions, unlike business-to-business ones.¹⁰ The launch of personal computers made the Internet accessible to the vast majority of people in the developed world¹¹ and, thus, resulted in an unprecedented growth of business-to-consumer e-commerce. In the 1990s e-commerce became what it is today,¹² an online shopping system that enables sales to be concluded through digital means.

E-commerce transactions were defined by the OECD as ‘the sale or purchase of goods or services, conducted over computer networks by methods specifically designed for the purpose of receiving or placing of orders’.¹³ This type of transaction has advantages over traditional commerce due to a variety of factors: it facilitates a convenient way of shopping, lower prices could be offered and also a greater variety of products is available compared to the one in physical stores.¹⁴ Several categories of e-commerce may arise, including online vendors, who do not have a physical presence but only warehouses through which the delivery of orders is fulfilled, such as Amazon. Another category is click and mortar business operations, which sell their products both through the Internet and through physical stores, such as Apple.¹⁵

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- 10 ‘Internet Online Shopping’ (Michael Aldrich 2011)
<http://www.aldricharchive.com/internet_online_shopping.html> accessed 19 April 2016.
- 11 TPA Global, ‘International Dimensions of the Digital Economy: Business Configurations, International Tax and Transfer Pricing Aspects’ (13 March 2015) 3 <<http://www.tpa-global.com/files/StreamFile909702/150312-international-dimensions-of-the-digital-economy.pdf>> accessed 19 April 2016.
- 12 *ibid.*
- 13 OECD, *OECD Guide to Measuring the Information Society 2011* (OECD Publishing 2011) 72, table 5.2
<http://www.keepeek.com/Digital-Asset-Management/oecd/science-and-technology/oecd-guide-to-measuring-the-information-society-2011_9789264113541-en#page1> accessed 19 April 2016.
- 14 ‘Ecommerce Sales Topped \$1 Trillion for First Time in 2012’ (E-marketer, 5 February 2013)
<<http://www.emarketer.com/Article/Ecommerce-Sales-Topped-1-Trillion-First-Time-2012/1009649>> accessed 19 April 2016.
- 15 For an analysis of the various methods of conducting e-commerce see Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 21-22.

B. The Spread of the Digital Economy

To understand the impact of the digital economy in the current world one should think of the origins of this new economy, which are the impact of ICT and especially the invention of the Internet.¹⁶ The ICT, around which both definitions of the digital economy evolved, in fact is a GPT and as such presents certain characteristics, which enable it to enhance productivity.¹⁷ Therefore, ICT ‘has become embedded’ in the business models of companies across various economic sectors.¹⁸

The Internet, in particular, was invented as a mean of improving communication,¹⁹ but soon enough it became a necessary technology driving substantial economic growth. McKinsey Global Institute stressed that the results of Internet on living standards were catalytic: on the 13 tested countries which account for more than 70 percent of the global Gross Domestic Product (GDP), within a period of 15 years of Internet maturity, the real GDP per capita was increased by \$500 on average.²⁰ Until 1981 though, when IBM launched personal computers and the Internet began to spread rapidly, the Internet had not that influential power to the economy.²¹ On the contrary, today the Internet, as a matter of fact, is more widespread than ever before and, thus, the digital economy is now accessible not only for sophisticated MNEs but also for consumers around the globe.

While these technological inventions illustrate the means that facilitated the spread of the digital economy, they do not explain the reasons behind its major spread. These reasons can be traced to the differences that this new economy has against the traditional one and the unique advantages that the digital economy offers to companies.²² To begin with, companies operating in the digital economy are

16 TPA Global (n 11) 3.

17 Ana Rincon, Michela Vecchi and Francesco Venturini, ‘ICT as a General Purpose Technology: Spillovers, Absorptive Capacity and Productivity Performance’ (Discussion Paper No. 416, National Institute of Economic and Social Research, 25 November 2013) 2 <http://niesr.ac.uk/sites/default/files/publications/dp416_0.pdf> accessed 19 April 2016.

18 OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 71.

19 TPA Global (n 11) 3.

20 Matthieu Pelissie du Rausas and others, ‘Internet Matters: The Net’s Sweeping Impact on Growth, Jobs, and Prosperity’ (McKinsey Global Institute, McKinsey & Company 2011) preface, 3 <<https://retelur.files.wordpress.com/2007/10/mckinseyreportinternetmattersmay11-110601131703-phpp02.pdf>> accessed 19 April 2016.

21 TPA Global (n 11) 3.

22 For a detailed analysis of the key characteristics of the digital economy see OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 84-95.

‘young and dynamic’.²³ Having been set up during the last decades enabled these enterprises to structure their business in a tax efficient way, for instance by locating some of their entities in low tax jurisdictions, a practice that leads to a low tax burden.²⁴ On the contrary, mature companies lack the ability to be dynamic, since in order to achieve such results they need to be engaged in costly restructurings, an option which is not often viable.²⁵

Moreover, mobility of business functions is another characteristic of the digital economy, which does not exist in the traditional one and as such, affects positively this new economy. Digital MNEs are able to manage their operations centrally and, consequently, avoid having a taxable presence in the markets where they operate.²⁶ Mobility, also, refers to intangible assets, which are regarded as a significant economic driver both for the value creation and the economic growth of digital companies.²⁷ Such assets may embed a significant part of MNEs’ global revenues and, thus, companies seek to locate intangible assets in jurisdictions where no or low taxation is imposed.²⁸ Through both the mobility of business functions and the mobility of intangibles, digital MNEs are able to optimise their tax position, much more effectively than companies that operate solely in the traditional economy.

Additionally, a factor that is considered as crucial for the success of digital MNEs is the development of ‘monopoly like positions’.²⁹ Such companies are thought to have prevailed based on monopoly strategies and in particular on high fixed costs and patent rights.³⁰ However, the development of monopolies does not imply that the digital economy will prevail over the traditional one. While it is true that digital MNEs are controlling a significant share of the world trade, it should not be overlooked that at the same time they have enhanced the capability of brick and mortar companies to reach remote markets. In e-commerce for instance, physical retailers are able to sell their products online and, thus, avoid the costs of running

23 Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 24.

24 *ibid.*

25 *ibid.*

26 *ibid.* 25.

27 OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 85.

28 Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 25.

29 *ibid.*

30 In general, monopolies can be characterised as natural monopolies, which take advantages of the natural sources of a particular region, or they can be established due to the high fixed costs associated with the relevant production process. Furthermore, monopolies may arise due to the development or the possession of a patent, which entitles a company with the advantage of creating or trading a certain good or service.

a store. Consequently, the digital economy should be regarded as a new area of operations, which exists along with the traditional one.

With regard to intangible assets though, monopoly strategies have become very significant, as only a few companies are able to afford the costs and the risks of their development. Intangibles have become a ‘main source of competitive advantage’³¹ the exploitation of which enhances the wealth capacity of companies.³² Digital MNEs spend significant amount of money on research and development (R&D) of intangible assets.³³ Then, the exploitation of these assets enables such companies to establish monopolies in the area of their operation. In conclusion, it is submitted that, while, as far as intangible assets are concerned, monopolies were indeed developed, the digital economy as a whole was not particularly reinforced by the existence of barriers to entry.

C. Transfer Pricing Considerations for the Digital Economy

The impact of e-commerce on transfer pricing manipulations was discussed more than ten years ago by the OECD. At that time, it was stressed that while the characteristics of e-commerce did not pose new problems for transfer pricing, certain difficulties (namely the application of the traditional transaction methods, the difficulty in establishing comparability and the tax treatment of integrated businesses) became even more salient.³⁴ Due to the fact that e-commerce has similar characteristics with other business models of the digital economy, the above mentioned complications should be considered as potential transfer pricing problems for the digital economy as a whole.

Moreover, the Commission stressed that the advantages of the digital economy over the traditional one exacerbated BEPS risks.³⁵ According to the OECD and the Commission, BEPS issues in the digital economy include, amongst others, the

31 A Bounfour, *Intangible Resources and Competitiveness: Towards a Dynamic View of Corporate Performance* (P Buiges et al (eds), Competiveness and the Value of Intangible Assets, Cheltenham, pp 17-41) pp 20-23 (as cited in Monica Boos, *International Transfer Pricing: The Valuation of Intangible Assets* (Kluwer Law International 2003) 33).

32 Monica Boos, *International Transfer Pricing: The Valuation of Intangible Assets* (Kluwer Law International 2003) 33-34.

33 OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 85.

34 OECD, *E-commerce: Transfer Pricing and Business Profits Taxation* (OECD Tax Policy Studies, No. 10, OECD Publishing 2005) 55 <http://www.oecd-ilibrary.org/taxation/e-commerce-transfer-pricing-and-business-profits-taxation_9789264007222-en> accessed 19 April 2016.

35 Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 24.

importance of intangible assets and their impact on transfer pricing.³⁶ The heavy reliance of digital MNEs on intangibles means that the current transfer pricing rules enable a significant portion of these companies' global revenue to be allocated to these companies' intellectual property (IP).³⁷ Therefore, as was already stated, digital players seek to transfer this IP to affiliate companies, which are located in jurisdictions where low or no taxation is imposed.

From the above, it is clear that the digital economy has a huge impact to the current way of doing business. Therefore, taxation should necessarily take this new economy into account. According to the position of both the OECD and the Commission, the economy is becoming digital and, therefore, it is not only possible, but also not desirable to distinguish digital activities from non-digital ones.³⁸ As a result, any BEPS risks arising in this new economy should be managed under the current tax rules. Accordingly, the transfer pricing problems of this new economy should be dealt with under the existing transfer pricing framework. Thus, in order to analyse the efficacy of the current transfer pricing methods for transfer pricing manipulations of digital MNEs, a closer look at these rules is essential. Moreover, a discussion regarding intangible assets is also important, in order to clarify their impact on transfer pricing.

II. Transfer Pricing the Digital Economy

In the globalised world, manipulation of internal transfer prices occurs when intra-group transactions are consciously overpriced or under-priced with the aim to maximize the income of a MNE.³⁹ From the tax authorities' perspective, transfer pricing becomes a problem because, through the overpriced or under-priced transactions, tax revenues of both jurisdictions where the two entities (parties of the transaction) are located could be distorted.⁴⁰ Consequently, the main problem, which transfer pricing rules are trying to settle, is to establish the correct amount of taxable profit for each entity participating in an intra-group transaction.

36 *ibid* 46; OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 15.

37 Commission Expert Group on Taxation of the Digital Economy, 'Report' (n 3) 46.

38 *ibid* 5; OECD *Addressing the Tax Challenges of the Digital Economy* (n 3) 12.

39 Lanz, R and S Miroudot, *Intra-Firm Trade: Patterns, Determinants and Policy Implications* (OECD Trade Policy Papers, No. 114, OECD Publishing 2011) 25 <<http://dx.doi.org/10.1787/5kg9p39lrwnn-en>> accessed 19 April 2016.

40 *ibid*.

The origins of the current transfer pricing rules are traced to the U.S.A, where the arm's length standard was introduced.⁴¹ This arm's length standard (otherwise known as the arm's length principle) became the international norm for transfer pricing, enshrined by the OECD, the United Nations and the United States Model Tax Conventions. According to Article 9 of the OECD Model Tax Convention, the arm's length principle aims to adjust the profits occurred between associated enterprises that transact with each other, so as to reflect the profits that would have been earned, had these transactions been carried through by 'independent enterprises in comparable transactions and comparable circumstances'.⁴² This Article, by requiring a comparison between the controlled and uncontrolled transactions in order to reach the correct arm's length result, is making comparability a vital issue for the application of the arm's length principle.⁴³ This importance of comparability is highlighted in the application and the further evaluation of the transfer pricing methods that determine the arm's length consideration.

A. The OECD-recognised Transfer Pricing Methods

The OECD Transfer Pricing Guidelines (the Guidelines) sanction five methods in order to determine whether a transfer price is consistent with the arm's length principle or if it is being manipulated. These methods are divided into traditional transaction methods, (ie the comparable uncontrolled price method, the resale price method and the cost plus method) and transactional profit methods, (ie the transactional net margin method and the transactional profit split method).⁴⁴ In 2010 the second set of methods was placed on an equal footing, as 'the most appropriate method for a particular case' should be applied.⁴⁵ However, even after this revised approach, the abolition of the hierarchical approach of the methods is

41 In 1917 the U.S. government was entitled to allocate income and deductions between affiliate companies, with the aim to prevent tax avoidance and determine each entity's tax liabilities. In 1935 the arm's length standard was formally introduced, in order to reflect the income of each company engaged in an intra-group transaction. For more details see Lorraine Eden, 'The Arm's-Length Standard in North America' (Special Reports, Tax Notes International 7 February 2000) 674
<<http://www.voxprof.com/eden/Publications/thearmslenghtstandardinnorthamerica.pdf>> accessed 19 April 2016.

42 OECD, *Transfer Pricing Guidelines for Multinationals Enterprises and Tax Administrations* (OECD Publishing 2010) para 1.6 <http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2010_tpg-2010-en#page1> accessed 19 April 2016.

43 *ibid.*

44 The same methods, though with few differences, are found in the U.S. transfer pricing regulations.

45 OECD, *Transfer Pricing Guidelines* (n 42) para 2.2.

not fully operative, as traditional transaction methods are preferable to the transactional profit methods, when both can be applied in an equally reliable manner.⁴⁶

While analysing the OECD-recognised methods in full detail is beyond the scope of this paper, it is necessary to provide their main characteristics. To begin with, the comparable uncontrolled price method (the CUP) compares the price charged in a transaction between associated enterprises with the one charged in a comparable uncontrolled transaction.⁴⁷ Comparability between these two transactions exists if “a) none of the differences (if any) between the transactions being compared or between the enterprises undertaking those transactions could materially affect the price in the open market; or, b) reasonably accurate adjustments can be made to eliminate the material effects of such differences.”⁴⁸

The resale price method works backwards. It uses the price at which a product (which was purchased from an affiliate company) was sold to an independent enterprise (ie resale price) and deducts from this price an appropriate gross margin.⁴⁹ This gross margin should amount to the operating costs, the selling expenses and the net profit of the seller.⁵⁰ The arm’s length price for the original purchase between the associated enterprises is what derives from this calculation.⁵¹ Finally, the cost plus method seeks to approximate the arm’s length price by adding the costs of the supplier of the property in a controlled transaction with an appropriate cost plus mark up.⁵² This mark up should be comparable to the amount that this supplier would have earned had it been an independent enterprise.⁵³

As opposed to the above described methods, the second group of methods looks at the net profit. The transactional net margin method (the TNMM) compares the net profit margin of the tested party in a controlled transaction, with that of a

46 Guglielmo Maisto, ‘OECD Revision of Chapters I-III and IX of the Transfer Pricing Guidelines: Some Comments on Hierarchy of Methods and Re-characterization of Actual Transactions’ in Dennis Weber and Stef van Weeghel (eds), *The 2010 OECD updates* (Vol 38, Wolters Kluwer 2011) 176.

47 OECD, *Transfer Pricing Guidelines* (n 42) para 2.13.

48 *ibid* para 2.14.

49 *ibid* para 2.21.

50 *ibid*.

51 *ibid*.

52 *ibid* para 2.39.

53 Elizabeth Hughes and Wendy Nicholls, ‘The Different Methods of TP: Pros and Cons’ (Tax Journal 28 September 2010) <<http://www.taxjournal.com/tj/articles/different-methods-tp-pros-and-cons>> accessed 10 April 2016.

comparable uncontrolled transaction of the same taxpayer or with that of a comparable transaction of an independent party.⁵⁴ The net profit is measured against an appropriate basis such as costs, sales and assets (net profit indicators).⁵⁵ This method is considered to be the most commonly used transfer pricing method, as is revealed from the data collected from various Advanced Pricing Arrangements.⁵⁶

As a final point, the profit split method splits the total profit earned in a transaction by all the affiliate companies that are involved in this transaction. It operates in two distinct steps: first, it identifies the profits that should be split (combined profits) and then it splits them in order to reflect the profits that each enterprise would have earned, had the transaction been between unrelated companies.⁵⁷ For the split of these combined profits, allocation keys are used 'depending on the facts and circumstances of the transactions'.⁵⁸ Two different methods of splitting the profits are described in the Guidelines, namely the contribution analysis and the residual analysis.⁵⁹ The profit split method has a significant difference to the previously described methods: while the other OECD-recognised methods (one-sided methods) seek to price the appropriate return of one party of the transaction without regard to the economic results of the other party, the profit split method looks at both parties of the transaction. However, the two-sided character of this method poses certain difficulties for its application. These complications will be examined in the fourth chapter.

At this point, it should be stressed that the choice of the appropriate method for each case is far from clear cut, as not all the methods are suitable for every kind of transactions. The comparability criteria that are imposed by each method have a crucial role in this choice, especially as far as the first set of methods is concerned. To be more specific, the CUP is considered the best method when its comparability criteria are satisfied.⁶⁰ However, these criteria are stringent and,

54 OECD, *Transfer Pricing Guidelines* (n 42) para 2.58. This method is a variant of the U.S. comparable profits method (CPM). For more details regarding the CPM see Reuven S Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* (Cambridge Tax Law Series, Cambridge University Press 2007) 115-116.

55 OECD, *Transfer Pricing Guidelines* (n 42) para 2.58.

56 Maisto (n 46) 178.

57 OECD, *Transfer Pricing Guidelines* (n 42) para 2.108.

58 *ibid* para 2.135.

59 For more information, see OECD, *Transfer Pricing Guidelines* (n 42) para 2.118-2.123.

60 OECD, *Transfer Pricing Guidelines* (n 42) para 2.14.

therefore, it has been contended that a 'CUP almost never exists'.⁶¹ The argument behind this extreme statement seems to be absolutely correct: even when a company sells a product both to its subsidiary and to unrelated buyers in the same market (which often is not the case), it does not sell this same product to an unrelated buyer at the same time.⁶² This differentiation at the time of the two sales may affect the comparability of the transactions and, thus, either the CUP will be applied improperly (ie as if the two transactions were indeed comparable) or it will not -and must not- be applied.

The resale price and the cost plus method rely, also, on comparability, but here the comparability criteria are more likely to be met. In both these methods, product differences do not affect the resale price margin and the cost plus mark up as significantly as they affect the price in the CUP.⁶³ In addition, as far as the cost plus method is concerned, the determination of the mark up may be highly problematic. Due to the differences between the 'costs that some companies record in their cost of goods sold and other companies may record in operating expenses', an identification of the mark up of comparable companies based on these companies' total costs may be necessary; however, this way around is in fact a profit-based method.⁶⁴ Last but not least, it is stressed that the need for less comparability is even more prevalent in the TNMM, as net profit indicators are not so sensitive to transactional and functional differences as the CUP and the resale price method respectively.⁶⁵

Finally, and in contrast to the rest OECD-recognised methods, in the profit split method comparability is not even an issue.⁶⁶ What really matters in this method is the results of each taxpayer.⁶⁷ Consequently, it should be accepted, that the more you move away from the CUP the less comparability is required.⁶⁸ Therefore, the profit split method can be particularly useful when direct comparables cannot be found. The potentials of the profit split method are going to be discussed in the fourth chapter, as they are considered to be particularly suitable to deal with transfer pricing of intangibles in the digital economy.

61 Reuven S Avi-Yonah, *International Tax as International Law: An Analysis of the International Tax Regime* (Cambridge Tax Law Series, Cambridge University Press 2007) 105.

62 *ibid* 104-105.

63 OECD, *Transfer Pricing Guidelines* (n 42) para 2.23, 2.41.

64 Hughes, Nicholls (n 53).

65 OECD, *Transfer Pricing Guidelines* (n 42) para 2.62.

66 Avi-Yonah (n 61) 117.

67 *ibid*.

68 *ibid*.

B. Intangible Assets and their Impact on Transfer Pricing

To understand why intangible assets play such a decisive role in transfer pricing manipulations of digital MNEs, it is necessary to consider the nature of such assets and how digital MNEs exploit them. To begin with, the precise definition of intangibles is a complex problem, due to the different perspectives that can be taken on the subject, such as the intellectual property perspective, the accounting perspective and the transfer pricing perspective. From a transfer pricing perspective, intangibles can be described as ‘nonphysical assets that allow an enterprise to earn profits above the profits the enterprise would have earned with only its physical assets’.⁶⁹ These intangibles are categorised in rights like contracts and franchises, customer relationships, undefined intangibles like goodwill, and IP.⁷⁰

The OECD in the Guidelines defined intangible property as rights to use industrial assets, literary and artistic property rights, IP and, also, business rights.⁷¹ Nevertheless, the OECD in Actions 8 – 10 of the BEPS project admitted that the definitions given on intangibles can be either too broad or too narrow.⁷² Therefore, it re-defined intangibles as ‘not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances.’⁷³

The starting point of the current problems regarding transfer pricing of intangibles seems to be the implicit hypothesis to which the international tax rules are based, namely that intangible assets represent passive assets.⁷⁴ However, due to the rapid evolution of the economy, intangibles have become dynamic assets that drive significant economic value. Such assets and digital MNEs are interrelated: ‘intangibles are crucial for the existence and boundaries of MNEs, while MNEs, in

⁶⁹ C Chandler and I Plotkin, *Economic Issues in Intercompany Transfer Pricing* (Tax Management Transfer Pricing Special Report, 2, 12, October 20 1993) 25 (as cited in Boos (n 32) 7).

⁷⁰ GV Smith and RL Parr, *Valuation of Intellectual Property and Intangible Assets* (3rd ed, 2000) 15 (as cited in Boos (n 32) 16-17).

⁷¹ OECD, *Transfer Pricing Guidelines* (n 42) para 6.2.

⁷² OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 2015 Final Reports* (OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris 2015) para 6.5 <<http://dx.doi.org/10.1787/9789264241244-en>> accessed 19 April 2016.

⁷³ *ibid* para 6.6.

⁷⁴ Colin Garwood, ‘Multinationals and the Great Tax Debate: A View from Industry’ (Tax Journal) <<http://www.taxjournal.com/tj/articles/multinationals-and-great-tax-debate-view-industry-21032014>> accessed 19 April 2016.

turn, are responsible for the proliferation of intangibles'.⁷⁵ This very relationship, along with the mobility of intangibles, creates tax considerations, especially in the digital economy, where the dynamic feature of intangibles is particularly prevalent: as digital MNEs are investing in the development of valuable intangibles, which are then traded within such groups (where the prices might be set with the aim to create a tax advantage), BEPS may arise.

The above described valuable intangibles can be transferred within a group of companies in four distinct ways: contribution to capital, sale, licence agreement and cost-sharing agreement, which in the Guidelines is referred as cost contribution arrangement (CCA).⁷⁶ As it will be illustrated in the next chapter, the most common way of transferring intangible assets within a MNE is either through a licence agreement or through a CCA.

A licence agreement provides the developer of the intangible (licensor) with the right to own the property and to dispose of it as the developer wants.⁷⁷ The rights of the licensee are the opposite to those of the developer, namely the licensee will get as much of the right as the developer will dispose. Due to the transfer of rights, the licensee should pay the licensor a royalty. A CCA on the other hand, should be regarded as an agreement that enables companies to mutually fund the R&D activity.⁷⁸ Due to this agreement, the participants will be able to exploit their share in the CCA without having to pay a royalty, as opposed to other non-participant companies, members of the same group.⁷⁹ Usually, a CCA corresponds to 'an arrangement for the joint development of intangible property'.⁸⁰ However, when a new member joins an existing CCA, the new member will capitalize any results of the prior CCA activity and, therefore, an arm's length compensation should be paid ('buy-in' payment).⁸¹

The Commission has provided an example of a simplified tax planning scheme, based on the transferability of intangibles, which represents the revenue flow of

75 Boos (n 32) 31.

76 PWC, *International Transfer Pricing 2013/2014* (PWC 2013) 87
< <https://www.pwc.com/gx/en/international-transfer-pricing/assets/itp-2013-final.pdf> >
accessed 19 April 2016.

77 *ibid.*

78 *ibid* 92.

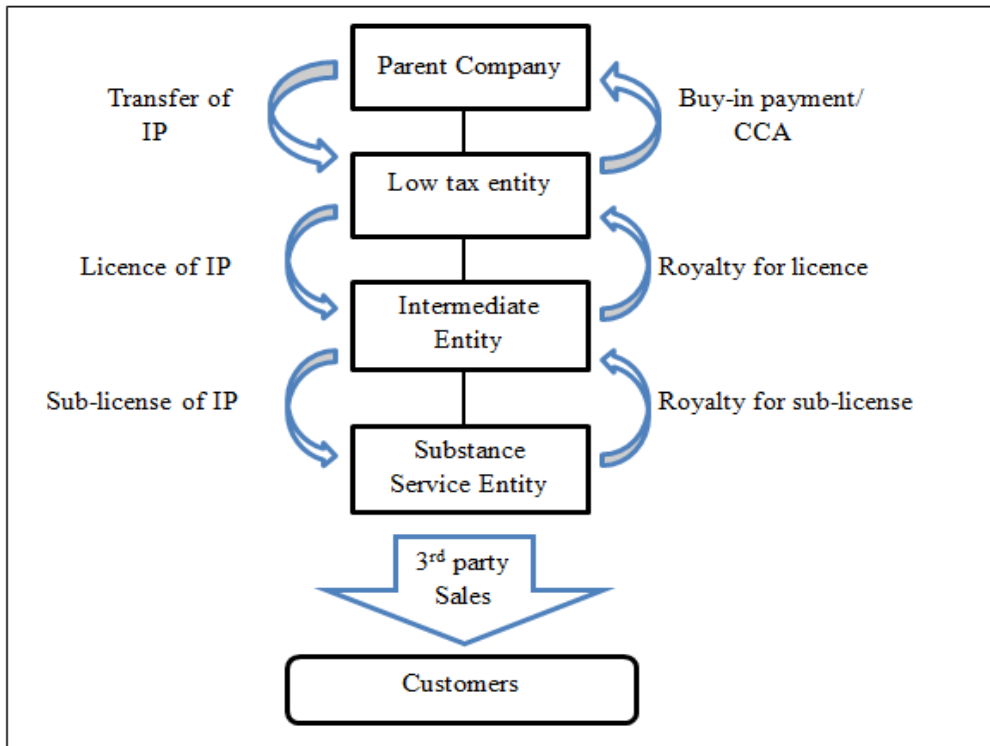
79 OECD, *Transfer Pricing Guidelines* (n 42) para 8.3.

80 *ibid* para 8.6.

81 *ibid* para 8.31

digital operations within the European Union.⁸² According to the Commission, such schemes do not arise only in the digital economy, but therein ‘they are particularly profitable and easy to use’.⁸³

The diagram that the Commission provided is reformulated into the following:



If adjusting the Commission’s example to an international context (ie not particularly referring to EU Member States), the above diagram is described as follows:

- A Parent Entity (residing where the central decision making of the group is taking place) transfers its valuable IP to a Low-Tax Entity in the form of a CCA.
- The Low-Tax Entity (which does not pay corporation tax, as a result of being resident in a tax haven or being subject to a special tax regime or being structured as a disregarded entity) licenses this IP to an Intermediate Entity and receives in return royalties. As long as these royalties remain to

⁸² For the Commission’s diagram and the relevant description see Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 42-43.

⁸³ Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 43.

the Low-Tax Entity (ie until the distribution to the parent company), they are tax free.

- The Intermediate Entity (residing in a country where a withholding tax on royalties is not levied) pays to the Low-Tax Entity royalties, on which a withholding tax is not imposed. In addition, it sublicenses the IP to a Substance Service Entity in return for a royalty payment.
- The Substance Service Entity sells the digital service or product to the customers in return of revenue and pays a royalty to the Intermediate Entity for the sublicense of the IP.

This example clearly illustrates how valuable intangibles can be transferred within a MNE with the aim to create a tax advantage. More specifically, it elucidates the methods according to which a licence agreement or a CCA can be manipulated in order to result into BEPS. Additionally, it should be highlighted that the rights to the IP of the Parent Company, were acquired by the Low-Tax Entity ‘at an early stage of its development for an arm's length price’.⁸⁴ The choice of the stage of early development for the transfer concerned is absolutely crucial. In this stage intangibles are considered as having high profit potentials and therefore are characterised as ‘crown jewels’, which are only transferred within the group.⁸⁵

In conclusion, it is observed that the transferability of intangibles coupled with the value that is embedded into this IP underlines the necessity for the current transfer pricing rules to be able to accommodate for such transfers. However, tax-efficient business structures of existing companies emphasise that not all of the above described transfer pricing methods are appropriate to decide the arm's length remuneration for transferred intangibles in the digital economy. Therefore, an investigation of the effectiveness of the OECD-recognised transfer pricing methods, based both on existing tax structures of large digital MNEs and on a theoretical analysis, is mandated.

III. A Case Study: The Commission's Investigations

In 2014 the Commission opened formal investigations against Luxembourg and Ireland due to their tax rulings regarding Amazon and Apple respectively. Tax rulings are letters by the tax authorities, which, amongst others, are used to

⁸⁴ ibid 42.

⁸⁵ Boos (n 32) 22, table 2.2.

approve the transfer pricing arrangements of a particular company.⁸⁶ While tax rulings are not of themselves illegal, they are becoming a point of discussion when they involve state aid.⁸⁷ Both in the case of Amazon and of Apple, the alleged state aid was linked with the compliance of the contested transfer pricing arrangement with the OECD transfer pricing rules. These rules are accepted by the Commission as an ‘appropriate guidance’ for arriving at an arm’s length result.⁸⁸

To understand the contested tax rulings, it is necessary to have a closer look at these investigations. Moreover, such an examination is considered crucial in determining whether the Commission’s claims are well founded based on the Guidelines and, more significantly, whether the latter are functional for companies operating in the digital economy.

A. The Commission’s investigation against Amazon

Amazon was incorporated in 1994 and soon enough it began selling products through the web.⁸⁹ To date, Amazon operates and designs retail websites, manufactures and sells electronic devices and is also engaged in the delivery of products and services through an extended delivery network. Amazon has organised its operations into two segments, namely North America and International.⁹⁰

According to the Commission’s State Aid investigation, in 2003 Amazon decided to restructure its operations in Europe by establishing its European headquarters in Luxembourg.⁹¹

⁸⁶ European Commission, ‘State Aid: Commission Investigates Transfer Pricing Arrangements on Corporate Taxation of Amazon in Luxembourg’ (Press Release, 7 October 2014) <http://europa.eu/rapid/press-release_IP-14-1105_en.htm> accessed 19 April 2016.

⁸⁷ *ibid.* Within the European Union a selective favourable regime addressed to a specific company might constitute illegitimate state aid. For a definition of the state aid see ‘Consolidated Version of the Treaty on the Functioning of the European Union’ (2012/C 326/01) Article 107 <<http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:12012E/TXT>> accessed 19 April 2016.

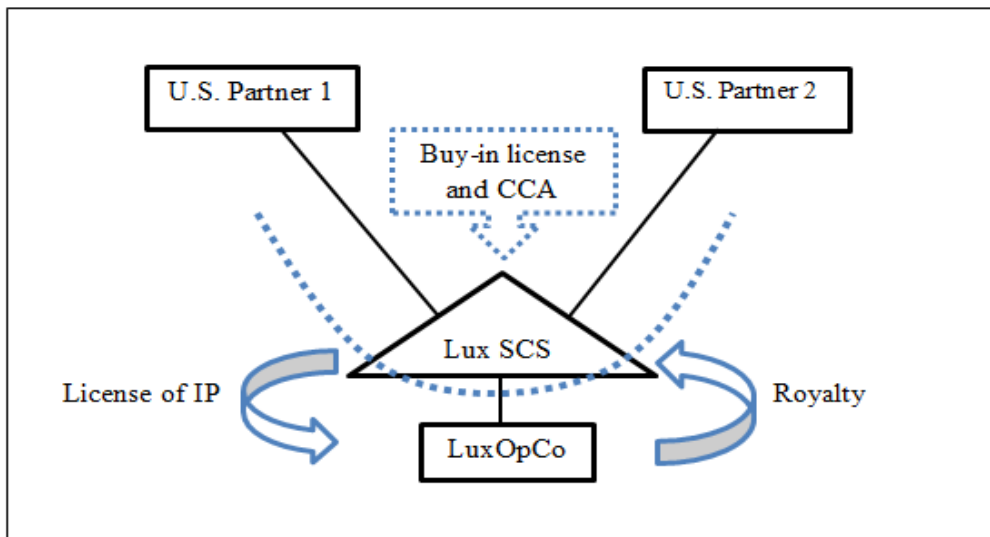
⁸⁸ European Commission, ‘State Aid SA.38944 (2014/C) – Luxembourg: Alleged Aid to Amazon by way of a Tax Ruling’ (7156 Final, 2014) para 55
<http://ec.europa.eu/competition/state_aid/cases/254685/254685_1614265_70_2.pdf> accessed 19 April 2016.

⁸⁹ Amazon.com, Inc., ‘Annual Report 1998’ 7; available online at <<http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-reportsannual>> accessed 19 April 2016.

⁹⁰ Amazon.com, ‘Annual Report 2014’ 3; available online at <<http://phx.corporate-ir.net/phoenix.zhtml?c=97664&p=irol-reportsannual>> accessed 19 April 2016.

⁹¹ European Commission, ‘State Aid SA.38944’ (n 88) para 28.

This new structure is depicted in the following diagram:



According to the above diagram, two U.S. partners hold all the shares in a Luxembourgish company, named Amazon Europe Technologies Holding SCS (Lux SCS). The latter, which is a disregarded entity for Luxembourg tax purposes, functions as an IP holding company. Lux SCS acquired its IP through a buy-in licence and CCA with Amazon.com.Inc and other U.S. affiliates. This company, also, owns LuxOpCo, another Luxembourgish company, which serves as the main operator of the retail and business services offered through Amazon's European websites. As LuxOpCo was not party to the buy-in licence and CCA, Lux SCS licenses its IP to LuxOpCo. Due to this licence, a tax deductible royalty should be paid by the latter to Lux SCS.⁹²

The determination of the royalty that should be paid by LuxOpCo to Lux SCS was established under a transfer pricing arrangement and was approved by the Luxembourg tax authorities in the form of a tax ruling.⁹³ The Commission expressed doubts regarding the compliance of this tax ruling with the principle that the remuneration owed should represent what a prudent independent operator would be willing to pay.⁹⁴ In particular, the Commission pointed out the determination of the royalty and the choice of the transfer pricing method used for

⁹² The new structure was described in the Commission's Letter regarding the alleged stated aid to Amazon. For a more detailed description of the targeted structure see European Commission, 'State Aid SA.38944' (n 88) para 28-31 and figure 1 p 10.

⁹³ European Commission, 'State Aid SA.38944' (n 88) para 36.

⁹⁴ *ibid* para 61-62. This principle should be regarded as the Commission's term for the arm's length principle.

this purpose as problematic aspects of the tax ruling.⁹⁵ The scope of this paper though, is focused solely on the application of the transfer pricing methods in the context of digital economy. Therefore, while the calculation of the royalty per se is beyond its scope, the methods that were suggested for this purpose by Amazon and discussed by the Commission are going to be examined.

However, before discussing these transfer pricing methods, a closer look at the company that owed the royalty due to the licence of the IP is necessary. LuxOpCo, as was already stressed, is the main operator of Amazon's websites in Europe and, thus, owns and uses the processing servers, which are located in Luxembourg.⁹⁶ The operations of Amazon's websites, along with the use of servers in order to fulfil transactions that were made online, falls into what has already been described as e-commerce. Consequently, as all the necessary functions for these online sales were carried out by LuxOpCo, this company should be regarded as a company operating in the digital economy and, thus, the methods that were suggested must be examined from the perspective of this new economy.

Two transfer pricing methods should be considered regarding the case at issue. To begin with, the Luxembourg tax authorities stressed that the same or substantially the same IP as the one that was granted to LuxOpCo was made available to third parties,⁹⁷ thus insinuating the potential use of the CUP. The profit split method was also applied, in order to analyse the functions and risks of the entities that were involved in the transaction, namely Lux SCS and LuxOpCo.⁹⁸ This profit split method used the residual analysis in order to allocate the combined profits. Accordingly, the remuneration of the less complex company, LuxOpCo, was established and then, the residual profits were attributed to LuxSCS in the form of a royalty.⁹⁹ As the two proposed methods provided similar results the profit split method was selected.¹⁰⁰

In contrast to the above choice, the Commission took the view that the CUP was the most appropriate method as 'is considered best at approximating conditions close to normal competition'.¹⁰¹ However, this preference should not be upheld as the degree of comparability that this method requires cannot be affirmed. To be more specific, there are questions arising regarding the similarity of the IP that

95 *ibid* para 66.

96 *ibid* para 31.

97 *ibid* para 43.

98 *ibid* para 44.

99 *ibid*.

100 *ibid* para 45.

101 *ibid* para 73.

was transferred to third parties with the one transferred to LuxOpCo. There is a sequence of arguments which can be used to support the view that no such similarity exists.

To begin with, Amazon itself has stressed the importance of its IP, as this IP is considered to be critical to the company's success and, therefore, it should be preserved as part of Amazon's proprietary rights.¹⁰² The company, also, admits that certain proprietary rights may be transferred to third parties.¹⁰³ In the case concerned, the Commission stressed that no information regarding the IP that was transferred was provided in the tax ruling request.¹⁰⁴ Moreover, as it was already stated, the IP of LuxSCS was licensed to LuxOpCo in order to enable the latter to operate the European websites. The fact that this IP was necessary for the operation of Amazon's websites, taken together with the non-disclosure of the relevant information, leads to the assumption that the IP at issue was vital for LuxOpCo's operations. Therefore, it is unlikely that this IP would have been transferred to third parties. Consequently, it is submitted that the CUP cannot be applied in this case due to the lack of comparability.

Furthermore, the Commission stressed that, especially since the application of a direct method is indicated by the tax authorities, an indirect method cannot prevail.¹⁰⁵ However, this preference is not justified. As the various methods have been put on an equal footing by the OECD, they should be treated as such. Therefore, the preference of both these organisations for direct methods should be abandoned, especially in the digital economy where, as it will be illustrated in the next chapter, methods that rely on comparability (ie the direct methods and the TNMM) are found to be inappropriate.

The method that was actually chosen on the other hand, namely the residual profit split, was rejected by the Commission.¹⁰⁶ One of the reasons behind this rejection was the inappropriateness of the method that was used in order to determine the remuneration of LuxOpCo (ie the TNMM). At this point it should be reminded that in the application of the profit split method through a residual analysis the remuneration of the less complex party should be established using one of the rest

102 Amazon.com, 'Annual Report 2014' (n 90) 4.

103 *ibid.*

104 European Commission, 'State Aid SA.38944' (n 88) para 32.

105 *ibid* para 73.

106 *ibid* para 74. The term residual profit split is usually found in the U.S. transfer pricing regulations. In the sense that is used here, it should be regarded as the OECD-recognised profit split method based on a residual analysis. For more details regarding the meaning of the residual profit split under the U.S. regulations and the Guidelines see Avi-Yonah (n 61) 117.

transfer pricing methods.¹⁰⁷ In the case concerned, the TNMM was selected and the less complex party was found to be LuxOpCo. However, the Commission correctly stressed that the operations of LuxOpCo seem complex.¹⁰⁸ Indeed, the latter company is engaged in a variety of activities, while the other party of the transaction, namely Lux SCS, is simply an IP holding company. As a result, it is ascertained that, indeed, the TNMM is not applied appropriately in this case and, consequently, the residual profit split should be rejected.

In conclusion and in opposition to the Commission's claims, it is submitted that the CUP is inappropriate for the case concerned. Furthermore, the profit split method should also be rejected, due to the false application of the TNMM. However, it is highlighted that the profit split method is not rejected because it is of itself inappropriate for the case at issue. According to the Guidelines, the application of one-sided methods for the determination of the remuneration of the parties of the transaction does not take into account any unique contributions of these parties.¹⁰⁹ As a result, the deficiency of the TNMM in the case concerned is justified. To overcome this problem, a more proper way of splitting the combined profits is required. Since the profit split method does not require a certain degree of comparability, which was found to be the problem in the application of the CUP in this case, the profit split method might be able to deliver an arm's length result in the case at issue, if modified properly. The potentials of this method for digital operations are going to be discussed in the next chapter.

B. The Commission's investigation against Apple

Apple is a US company whose popularity soared during the last ten years due to its innovative products, such as the i-Phone, the i-Pad and Mac computers. Apart from the design, manufacturing and marketing of certain tangible products, the company is also engaged in the sales of innovative related software and other networking solutions.¹¹⁰ Apple products are sold worldwide through a variety of means such as retail stores, online stores and direct sales force.¹¹¹ Due to the advance of the Internet in recent years, online retail has become a vital mean of sales for Apple Inc. and, therefore, Apple should be considered as an e-commerce player. More significantly though, Apple is engaged in the digital economy because of its

107 OECD, *Transfer Pricing Guidelines* (n 42) para 2.121.

108 European Commission, 'State Aid SA.38944' (n 88) para 74.

109 OECD, *Transfer Pricing Guidelines* (n 42) para 2.121.

110 Apple Inc., 'Form 10-K (Annual Report) Filed 10/27/14 for the Period Ending 09/27/14' 1 <<http://files.shareholder.com/downloads/aapl/3843246012x0xs1193125-14-383437/320193/filing.pdf>> accessed 19 April 2016.

111 *ibid.*

pioneering software. This high-tech software is not only used in the manufacturing of Apple devices, but is also commoditised as it being used by customers and sold to them, for instance through the App store.

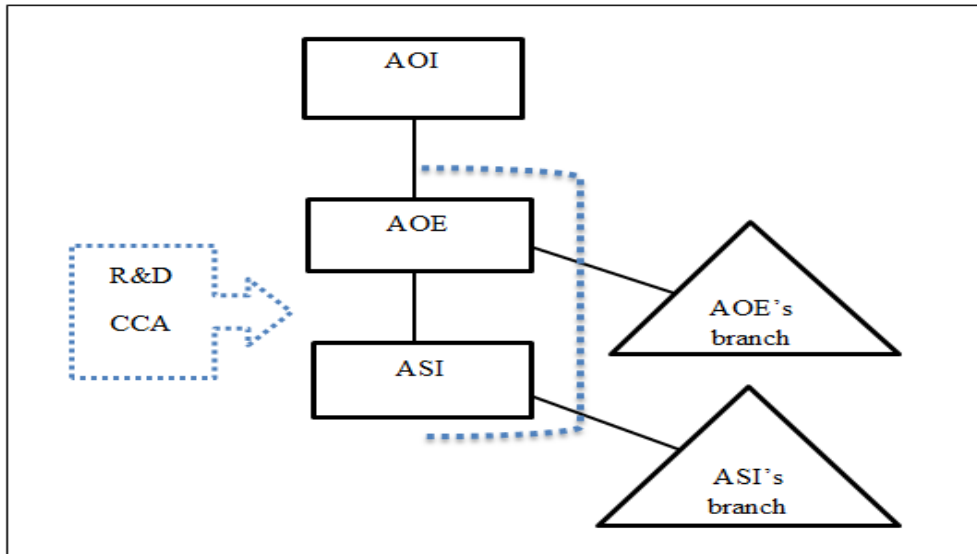
However, Apple's success story should not only be attributed to its admittedly pioneering products. It should also be traced to its tax efficient structure, according to which Apple, in order to support its worldwide operations, relies on a network of subsidiaries around the world, several of which are incorporated in Ireland.¹¹² According to the Commission's State Aid investigation, the following points are crucial regarding Apple's structure:

- As opposed to most of Apple's companies that are incorporated in Ireland, Apple Operations International (AOI), its subsidiary, Apple Operations Europe (AOE), and the subsidiary of the latter company, Apple Sales International (ASI), are not tax residents therein.
- AOE and ASI are both engaged in trade operations in Ireland, which are carried out through their Irish branches.
- The AOE's branch's main activity is the manufacture of a specialised line of personal computers.
- Through a R&D CCA between Apple Inc., AOE, ASI and other Apple Inc. subsidiaries the total costs of the group's worldwide R&D are pooled and the IP rights of the US parent are granted to these companies, while Apple Inc. retains the legal title. These IP rights are not attributed to the aforementioned branches.

The above described structure, along with the transfer of IP is depicted in the following diagram.¹¹³

¹¹² 'Testimony of Apple Inc. before the Permanent Subcommittee on Investigations US Senate' (21 May 2013) 8 <https://www.apple.com/pr/pdf/Apple_Testimony_to_PSI.pdf> accessed 19 April 2016.

¹¹³ For the Commission's diagram regarding Apple's structure in Ireland, as well as the Commission's description regarding the structure at issue, see European Commission, 'State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) – Ireland: Alleged Aid to Apple' (3606 Final, 2014) para 19-29 <http://ec.europa.eu/competition/state_aid/cases/253200/253200_1582634_87_2.pdf> accessed 19 April 2016.



With regard to the above described strategy, the tax advisor representing Apple admitted that the company was engaged in transfer pricing.¹¹⁴ In order to deal with this transfer pricing manipulation and calculate the arm's length prices, the TNMM was chosen.¹¹⁵ However, the Commission stressed that this method was inappropriate. In particular, the Commission highlighted that the chosen net profit indicator (ie operating costs) was not justified, due to the fact that there was a 'specific know-how in the branch which is remunerated at [1-9]% of branch turnover'.¹¹⁶ According to the Commission's argument, costs are an appropriate net profit indicator when production is carried out, unless this production requires 'a specific valuable such as a unique intellectual property right'.¹¹⁷ Therefore, the existence of a unique valuable in the above sense should be examined.

In the case concerned, the turnover was granted by AOE to its branch, due to 'the accumulated manufacturing process technology of the Irish branch'.¹¹⁸ As has already been stated, this manufacturing activity aims at the creation of a specialised

¹¹⁴ European Commission, 'State Aid SA.38373 (2014/C) (ex 2014/NN) (ex 2014/CP) – Ireland:

Alleged Aid to Apple' (3606 Final, 2014) para 37

<http://ec.europa.eu/competition/state_aid/cases/253200/253200_1582634_87_2.pdf> accessed 19 April 2016.

¹¹⁵ *ibid* para 60.

¹¹⁶ *ibid*.

¹¹⁷ *ibid*.

¹¹⁸ *ibid* para 32.

line of personal computers, which, due to their specified requirements, entail the use of a specific technological knowledge, namely know-how.¹¹⁹ As a result, it is clear that this know-how was absolutely necessary for the operations of AOE's branch. Moreover, it is obvious that the latter could not acquire this IP through another way (such as purchasing it from an independent party), as this IP was only available to Apple affiliates. As a result, it is concluded that the IP at issue was indeed a unique valuable and, thus, the Commission's claim is valid.

C. The Outcomes from the Above Investigations

The above examined cases provide important findings for transfer pricing purposes both regarding the Commission's view on this issue and the current transfer pricing practices of digital MNEs, which need to be elucidated. To begin with, in both cases, the chosen methods are considered as inappropriate, though for different reasons. In the Amazon case, the profit split method is rejected, amongst others, due to the false application of the TNMM, since the tested party was not the less complex one. In the Apple case on the other hand, the TNMM was rejected due to the transfer of unique know-how, which hampered the application of the chosen net profit indicator.

In addition, the nonexistence of comparability in the Amazon case triggers questions regarding the application of one-sided methods, as they are based more or less on comparability. This argument is even stronger, since the thinking regarding comparability in Amazon case, also, applies to the Apple case. In the latter, the fact that the manufactured computers belong to a special line implies that there are few possibilities for the IP concerned to have been transferred to unrelated parties. Moreover, as Apple products are characterised by their unique pioneering technology, the required know-how for their development must remain undisclosed and, thus, it is even more unlikely that Apple transfers such know-how to independent companies. As a result, it comes out that whenever unique IP is transferred comparability cannot be satisfied, and, therefore, the application of methods that rely on comparability is not feasible.

As far as the tax planning schemes of digital MNEs are concerned, it should be stressed that the structures of Amazon and Apple do not differ significantly from the Commission's example, which was described in the previous chapter. All these three schemes involve the use of a certain type of agreement, namely a CCA or a licence agreement, in order to transfer intangibles to affiliate companies. Moreover, an important common characteristic of the Commission's investigations

¹¹⁹ Know-how is included in the Guidelines' definition of intangibles and is also treated as an intangible under Actions 8 – 10 (see OECD, *Transfer Pricing Guidelines* (n 42) para 6.2; OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10* (n 72) para 6.20).

examined, is that both companies transfer intangible assets, which are in fact unique technological know-how. As a result, it is submitted that while such companies may transfer their valuable IP through different structures, they act within the same framework. This result is even more reasonable, if one takes into account the common characteristics of the companies that operate in the digital economy. Consequently, the findings arising from the Commission's investigations should be taken into account when determining the appropriateness of the current transfer pricing methods for the digital economy as a whole.

In conclusion, this chapter clearly illustrated the current practices for transfer pricing of intangibles in the business reality. It also underlined that some of the currently accepted OECD-recognised methods are not fit for purpose for intra-group transfers of intangible assets in the digital economy. However, since certain methods were not discussed a method-by-method analysis is considered as necessary. Such an analysis will not only address the efficacy of the methods that were not examined in this chapter, but also will provide a theoretical evaluation of the methods already discussed, in order to reach a definite result regarding the appropriateness of all the OECD-recognised methods for transfer pricing of intangibles in the digital economy.

IV. A Theoretical Approach of the OECD-Recognised Transfer Pricing Methods Regarding Intangibles

In a theoretical analysis of the transfer pricing methods regarding intra-group transfers of intangibles, the current work of the BEPS project on intangibles should be considered. BEPS Actions 8 – 10, provided significant guidance on this area and repeated that '(i) the nature of the relevant intangibles, (ii) the difficulty on identifying comparable uncontrolled transactions and intangibles in many, if not most, cases, and (iii) the difficulty of applying certain of the transfer pricing methods' should be taken into account.¹²⁰ As has already been demonstrated by the previously examined cases, all these difficulties apply to digital MNEs. Therefore, the guidance provided in the aforementioned actions regarding intangibles should be applied, by analogy, to the specific case of transfer of intangibles in a digital context, as there is no good reason to distinguish intangibles of the digital economy from intangibles of the traditional economy.

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OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10* (n 72) para 6.131

A. An Assessment of the OECD-recognised Transfer Pricing Methods

To begin with, the CUP, as has already been stressed, relies heavily on comparability, a criterion that is rather difficult to be met in intra-group transfer of intangibles by digital MNEs. Such companies invest in the creation of unique intangibles, which, as has already been illustrated, grant monopolistic power to these companies. This power is of itself a problem for the application of the CUP: if a company is the only one operating in a specific business area, it will be rather difficult to find comparable uncontrolled transactions, so as to satisfy the stringent comparability criteria of this method. Therefore, Actions 8 - 10 pointed out the identification of comparables regarding the intangibles transferred, as a main difficulty on the application of this method.¹²¹

As far as the resale price method and the cost plus method are concerned, it should be recalled that they both rely on comparability. More specifically, the resale price margin and the cost plus mark-up are established on internal comparables (ie based on the results of the tested company from comparable uncontrolled transactions) or external ones (ie based on the results of an independent enterprise from comparable uncontrolled transactions), while the first category is preferred. However, as it was illustrated in the case of Amazon, the IP transferred was so crucial for the operation of the websites that most likely would only be transferred amongst Amazon's affiliates, and, therefore, internal comparables would not exist. As far as external comparables are concerned, due the existence of monopolies that was analysed above, such comparables are also unlikely to exist. Moreover, the fact that the resale price and the cost plus method are preferred for certain kinds of transactions, namely when the reseller of the product does not alter the product substantially¹²² and when semi-finished products are sold within a group¹²³ respectively, makes them even less appropriate for the type of transfer concerned.

Additionally, it is of particular importance that the U.S. regulations do not even include the resale price method and the cost plus method as possible solutions regarding the transfer pricing of intangible assets.¹²⁴ Since our transfer pricing rules originated in the U.S.A., due regard should be given to the fact that these methods are excluded from the U.S. regulations. In line with these regulations, Actions 8 - 10 do not refer to the resale price method and the cost plus method when discussing possible solutions regarding transfer pricing of intangibles assets. This omission implies that these two methods are not appropriate.

¹²¹ ibid 6.146.

¹²² OECD, *Transfer Pricing Guidelines* (n 42) para 2.29.

¹²³ ibid para 2.39.

¹²⁴ A. Oestreicher, *Konzern – Gewinnabgrenzung: Gewinnabgrenzung, Gewinnermittlung, Gewinnaufteilung* (Munich, 2002) pp 60/66 (as cited in Boos (n 32) 121 fn 474).

The TNMM cannot be applied either in transfer pricing of intangible assets, due to the above described lack of comparability. The fact that this method should be applied in a consistent manner with the resale price and the cost plus method means that internal comparisons will be preferred from external ones.¹²⁵ Nevertheless, it has already been illustrated that such comparables do not exist whenever unique intangibles are transferred.

Furthermore, Actions 8 - 10 reinforced the view that the cost-based methods are not particularly reliable regarding intangibles, by stressing that the cost of creating an intangible and their ultimate value (ie value at the moment of the transfer) may differ significantly.¹²⁶ Indeed, costs do not appropriately reflect the value of an intangible, as this value is determined by demand and supply.¹²⁷ More than that, costs do not account for the future benefit from the exploitation of an intangible, which, though, is the *raison d'être* for licensing such assets.¹²⁸

Actions 8 – 10, by taking the view that one sided-methods are not particularly reliable for a direct evaluation of transferred intangibles, practically suggested the use of a two-sided method, namely the profit split method.¹²⁹ In particular, it was stressed that whereas limited rights in fully developed intangibles are transferred and comparable uncontrolled transactions do not exist, the transactional profit split method might be a solution.¹³⁰

The clarification of the use of the profit split method was one of the objectives of BEPS Action 10. This Action Plan was delivered as part of Actions 8 – 10, but this part is essentially the basis of a draft guidance that will be developed in the future.¹³¹ With regard to the action at issue, 'BEPS Action 10: Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains' (the Discussion Draft 10) was issued. As a result, until the issuance of the finalised guidance, the discussion draft at issue remains a focal point of discussion.

The Discussion Draft 10 analysed various scenarios, which can be used as arguments in favour of the use of the profit split method in MNEs' intra-group

125 OECD, *Transfer Pricing Guidelines* (n 42) para 2.58.

126 OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10* (n 72) 6.142.

127 Boos (n 32) 77.

128 *ibid* 78.

129 OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10* (n 72) 6.141.

130 *ibid* para 6.152.

131 *ibid* p. 55, 56 Summary.

transactions. According to the first scenario, three EU associated manufacturing enterprises engaged in manufacturing are basically independent from their non-EU parent, apart from the fact that they have licensed technology IP from the parent, for which they are paying a royalty.¹³² These three enterprises are highly integrated as they have a central decision making, they are trading with one another and the success of their business is largely based on their common portfolio.¹³³ Due to this interdependence, one-sided methods are considered as unsuccessful to determine an arm's length royalty for the above remuneration regarding their intra-group transactions, as it will be difficult to find reliable comparables.¹³⁴ On the contrary, through the profit split method, the level of aggregation of these enterprises would be examined carefully before determining the profits to be combined.¹³⁵

This scenario clearly illustrates the level of integration of a global value chain. As far as digital MNEs are concerned, they should be regarded as such global value chains as they are engaged as a whole in the process of 'design, production, marketing, distribution and support to the final consumer'.¹³⁶ Therefore, by analogy to this scenario, the high level of integration of digital MNEs manifests the shortcomings of the application of one sided-methods regarding intra-group transfers. This integrated nature of digital MNEs is, also, illustrated in the second scenario, which refers directly to a digital company¹³⁷ and, thus, it can be an even stronger argument in favour of the profit split method in a digital environment.

Moreover, the feature of fragmentation underlines the interdependence of MNEs. To be more specific, as MNEs are separating their functions (eg logistics, warehousing, marketing, and sales functions) into their affiliate companies, it is difficult to identify comparable transactions for so specialised and narrow activities.¹³⁸ Consequently, in such a case the profit split method should be preferred as well. As far as digital MNEs are concerned, it has been illustrated that fragmentation is prevalent in these groups. Therefore, the findings of

132 OECD, 'BEPS Action 10: Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains' (Public Discussion Draft, OECD 16 December 2014 - 6 February 2015) para 9 <<http://www.oecd.org/ctp/transfer-pricing/discussion-draft-action-10-profit-splits-global-value-chains.pdf>> accessed 19 April 2016.

133 *ibid* para 11.

134 *ibid*.

135 OECD, *Transfer Pricing Guidelines* (n 42) para 2.124.

136 Porter, 1986; Gereffi et al., 2001 (as cited in OECD, *Interconnected Economies: Benefiting from Global Value Chains* (OECD Publishing 2013) 14 Box 1.1 <<http://dx.doi.org/10.1787/9789264189560-en>> accessed 19 April 2016).

137 OECD, 'BEPS Action 10: Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains' (n 132) para 14-16.

138 *ibid* para 26.

Discussion Draft 10 regarding the application of the profit split method should be applied by analogy to such groups. Taking all the above into consideration, it is submitted that due to the high degree of integration of digital MNEs, the profit split method seems to be the only viable solution for transfer pricing manipulations of such companies.

However, one might argue that in the investigations examined in the previous chapter only one party of the transaction made unique contributions and, therefore, the TNMM should apply.¹³⁹ This argument is even stronger as the Guidelines emphasise that the profit split method is particularly useful, when both parties of the transaction make unique and valuable contributions.¹⁴⁰ Nevertheless, this view in favour of the TNMM should not be upheld. In order to decide in favour either of the TNMM or the profit split method, a dividing line between the circumstances when these two methods apply should be drawn. Indeed, when unique contributions are made only by one party of the transaction the TNMM may apply. The highly integrated nature of digital MNEs though, hampers the application of one-side methods and, consequently, of the TNMM. Therefore, it is concluded that the transfer of unique intangibles (even from only one party of the transaction), coupled with the high degree of integration of a digital MNE, mandates the use of the profit split method.¹⁴¹

B. The Way Forward

While the profit split method was found to be the only viable transfer pricing method for transfer pricing of intangibles by digital MNEs, its application, as it is regulated in the Guidelines, is rather problematic. The Guidelines point out the inability to access the information needed from foreign affiliates and also the difficulty ‘to measure the combined revenue and costs for all the associated enterprises participating in the controlled transactions’ as the main shortcomings of this method.¹⁴² However, given the fact that digital MNEs need to gather such information for group consolidation, these arguments are not absolutely

¹³⁹ OECD, *Transfer Pricing Guidelines* (n 42) para 2.59. However, it should be remembered that Apple’s investigation clearly illustrated that the application of the TNMM was problematic due to the unique know-how that was transferred.

¹⁴⁰ *ibid* para 2.109.

¹⁴¹ This conclusion is line with the key themes which need to be revised according to Actions 8 – 10. In particular, it is stressed that a) the profit split method may be used in cases where no comparables are available, without examining whether this method is itself appropriate and b) a high level of integration is not a sufficient factor so as to choose the profit split method. For more information see OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10* (n 72) 58 para 7, 8. However, in cases where these two factors are combined, the application of the profit split method seems to be the only way forward.

¹⁴² OECD, *Transfer Pricing Guidelines* (n 42) para 2.114.

convincing.¹⁴³ As a result, these arguments cannot be considered as reasons due to which the use of the profit split method for transfer pricing of intangibles by digital MNEs should be rejected.

In contrast, an existing problem for the application of the profit split method arose through the examination of the Commission's investigation regarding Amazon. In particular, this case illustrated that applying a residual analysis (and consequently an one-sided method) is problematic, since one-sided methods disregard any valuable contributions of the parties of the transaction. Additionally, the allocation keys that are suggested by the Guidelines are considered to be subjective¹⁴⁴ and Actions 8 – 10 stressed that there is a little guidance on how the profits should be split.¹⁴⁵ As a result, it clearly comes out that applying the profit split method, as it is, to digital operations is not the best way to deal with transfer pricing manipulations regarding intangibles in the digital economy.

To overcome the aforementioned difficulties, modifications to the current profit split method are required. A way forward could be a simplified version of this method based on a list of certain predetermined criteria for the allocation of the combined profits amongst the various members of the group, where a case-by-case analysis would not be necessary.¹⁴⁶ In order to apply this method, a set of allocation keys that will correspond to the specific features of the digital economy is necessary. Since the main practical problem with the profit split method is the division of the combined profits, a predetermined list of allocation keys is considered as particularly beneficial. Additionally, this solution will deliver a set of objective allocation keys and, thus, will solve the above mentioned problem of subjectivity.

At this point, it should be stressed that the solution of using partly predetermined allocations keys has been proposed for transfer pricing of intangibles as part of applying an activity based-formulary apportionment.¹⁴⁷ In this context, the use of 'specific intangible related factors referring to activities and/or industries'¹⁴⁸ for the allocation of the combined profits was suggested, and, therefore, various factors

¹⁴³ Boos (n 32) 187.

¹⁴⁴ OECD, 'BEPS Action 10: Discussion Draft on the Use of Profit Splits in the Context of Global Value Chains' (n 132) para 35.

¹⁴⁵ OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10* (n 72) 59 para 13.

¹⁴⁶ Jeffery M Kadet, 'Expansion of the Profit-Split Method: The Wave of the Future' (Tax Analysts, 30 March 2015) 1185-1186
< http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2593548 > accessed 19 April 2016.

¹⁴⁷ Boos (n 32) 213-214, 217.

¹⁴⁸ *ibid* 216.

such as the costs of developing intangibles, sales and the risk assumed were scrutinised.¹⁴⁹

As this activity based-formulary apportionment (at least as far as the predetermined allocation keys are concerned) is similar with the simplified profit split proposed above, the findings of this analysis regarding the examined allocation keys should be taken into consideration regarding intangibles transferred within digital MNEs. For instance, while adopting sales as an allocation key ‘reflects the importance of each market’,¹⁵⁰ it has also been stressed that sales might not be an accurate factor for intangibles as they are not indicative of ‘the level of intangible development activity’.¹⁵¹ Therefore, in order to identify the allocation keys that will be used under the simplified profit split in the context of the digital economy, it is proposed that a thoroughly analysis should be conducted. This analysis must take into account that the selected allocation keys should not only be functional for the purposes of the digital economy, but also they should be appropriate to measure the intangibles transferred.

On a different basis it should be noted, that when considering amendments in one of the accepted transfer pricing methods, it cannot be overlooked that the fundamental principle, on which these methods are based, is not unanimously accepted as the best solution. Although being used as an international norm, the arm’s length principle has been highly criticized as it disregards the business reality of the modern economy by treating affiliate companies as separate enterprises. Furthermore, recently, this principle was described as part of the problem and not as part of the solution, since it gives rise to a number of subjective transfer prices.¹⁵² Proponents of the departure from the arm’s length principle suggest the use of a formulary apportionment, a method that resembles similar characteristics to the solution proposed above. The formulary apportionment would tax an MNE group on a consolidated basis using a predetermined formula and, therefore, would abandon the separate entity approach.¹⁵³

The solution proposed is as a compromise between the use of a formulary apportionment and the existing profit split method. In this way, the principal deficiencies of the latter, namely the fact that it uses a sort of an allocation formula and, thus, it satisfies the arm’s length principle only indirectly, may well lead to

¹⁴⁹ *ibid* 217-219.

¹⁵⁰ Kadet (n 146) 1187.

¹⁵¹ SO Lodin and M Gammie, *Home State Taxation* (2001) 47 (as cited in Boos (n 32) 218).

¹⁵² Kadet (n 146) 1184.

¹⁵³ OECD, *Transfer Pricing Guidelines* (n 42) para 1.19.

the desired result, namely a method that ‘at least to some extent considers both the integrated nature of MNEs and the ALS’.¹⁵⁴

To this point, it should be stressed that the formulary apportionment has not been approved by the OECD, mainly, due to the difficulty of reaching an agreement regarding the characteristics of the predetermined formula.¹⁵⁵ The argument regarding the practical difficulty of reaching an agreement may, also, arise in a discussion relating to the determination of the proposed predetermined list of allocation keys as part of the simplified profit split method and the further success of this method.

However, in the digital economy this problem seems to not be that important so as to lead to the rejection of the proposed method. Since digital business models resemble a high degree of uniformity, it is anticipated that an agreement regarding the determination of the predetermined allocation keys is likely to be reached. To be more specific, such business models share common key features, which might be critical from a tax perspective.¹⁵⁶ Due to their decisive role in taxation, these characteristics should be taken into account when determining the allocation keys relevant to this new economy. By taking such common characteristics of digital operations into consideration, it is assumed that the allocation keys that will be chosen for the digital economy will allow the tax authorities to reach an agreement. Moreover, these allocation keys might, also, be sufficient to deal with new business models that may arise, as long as these models will evolve in the framework of the digital economy and, consequently, will present similar characteristics to the existing digital business models.

Last but not least, it should be examined whether the solution proposed above is in line with the standing position of both the Commission and the OECD, namely that this new economy should not be ring-fenced¹⁵⁷ and that the current rules ‘should be applied or adapted so that “digital” companies are treated in the same way as others’.¹⁵⁸ These two statements clarify the position of the above organisations: new rules addressed to the particular needs of the digital economy must not be delivered. Since this paper suggests a change of the current framework in response to the unique features of the digital economy, this position should be taken seriously into consideration.

154 Boos (n 32) 185. The term ALS refers to the arm’s length standard.

155 OECD, *Transfer Pricing Guidelines* (n 42) para 1.23.

156 OECD, *Addressing the Tax Challenges of the Digital Economy* (n 3) 84.

157 *ibid* 12.

158 Commission Expert Group on Taxation of the Digital Economy, ‘Report’ (n 3) 5.

As a first point, it should be stressed that the above discussed solution is not a new rule; it does not require to form a new profit split method, but rather to adopt specific allocation keys, which will correspond to the operations of digital MNEs. Most significantly, the proposed simplified profit split is based on the same reasoning as the OECD-recognised profit split method and, thus, it cannot be claimed that it is a new method. The difference between the two is that the proposed method suggests different means to reach the desired result (namely the split of the combined profits). However, it may still be argued that adopting industry specific allocation keys amounts to a kind of ring fencing. Indeed, the adoption of such allocation keys is actually a specific solution for a specific problem. Nevertheless, due to the dramatic changes in the modern economy, it became apparent that trying to solve new problems with old rules is certainly not the way forward. Therefore, a moderation of the common position of the OECD and the Commission is mandated.

To conclude, it was clearly explained that the current transfer pricing methods are not functional to deal with transfer pricing of intangibles in a digital context. Moreover, it was stressed that a departure from the arm's length principle and the OECD-recognised methods is not desirable. As the aim is to fix the current rules and not to try to change them, a modification of the method that approximates the best results regarding operations of digital MNEs was proposed: a simplified profit split based on certain predetermined criteria that would facilitate the split of combined profits. This new profit split method will enable intra-group transfers of intangibles in the digital economy to be remunerated appropriately, as both the complex business relations of a MNE and the unique intangibles that are traded in such groups will be taken into account. Last but not least, it is submitted that the proposed solution is not an entirely new rule, but a modification of the current profit split method, in order to address some of the problems that have arisen in the digital era.

Conclusion

This research assessed the efficacy of the OECD-recognised transfer pricing methods for intra-group transfers of intangibles in the context of the digital economy. Due to the extensive use of the Internet, this new economy has spread rapidly and, thus, has given rise to new business models, while existing ones, such as the e-commerce, have gained significant boost. In this new era of business operations, transfer pricing of intangibles has emerged as a significant tax consideration. It has been illustrated that intangibles embed significant value and, therefore, their transfer to low or no tax jurisdictions is particularly advantageous. The practice of transferring intangibles within digital MNEs has become

widespread and, thus, it indicates even more the difficulty in the application of the current transfer pricing methods in the context of the digital economy.

In order to evaluate the OECD-recognised methods for the purposes of the digital economy, an analysis of the Commission's investigations regarding Amazon and Apple was conducted from a transfer pricing perspective. This analysis highlighted that digital MNEs are engaged in intra-group transfers of intangible assets, which are crucial for their business operations and, therefore, they can be characterised as unique. Such unique intangibles though, hamper the comparability analysis. Therefore, transfer pricing methods that rely on comparables were found to be inappropriate for transfer pricing of intangibles by digital MNEs.

Additionally, a method by method analysis was completed, which stressed even more the importance of comparability for the application of the one-sided methods and, accordingly, the inappropriateness of these methods. In particular, the heavy reliance on comparability, coupled with the uniqueness of the transferred intangibles, impedes the application of the traditional transaction methods and of the TNMM. On the contrary, the profit split method was found to be the only viable solution for intra-group transfers of intangibles, as it takes into consideration the unique IP that is being transferred, along with the high degree of integration of digital MNEs.

Nonetheless, the application of the profit split method is rather problematic, mainly due to the difficulty to divide the combined profits of the participants in an intra-group transaction. In order to deliver a method reliable for the transfer pricing manipulations regarding intangibles in the digital era, a simplified profit split method is proposed. According to the latter, combined profits will be allocated based on a set of predetermined criteria, which will be particularly addressed to the features of digital business models. Due to the degree of uniformity of such models, it is reasonable to assume that this solution would facilitate an agreement between the tax authorities.

In order to align the solution proposed with the positions of the OECD and the Commission regarding the taxation of the digital economy, it was clarified that the proposed method is not a new rule. It is instead, a modification of the existing profit split method based on the same rationale as this method. However, as this modification includes the adoption of industry specific allocation keys, it might amount to a partially ring-fencing of the digital economy. The rapid evolution of this new economy though, elucidated that rules developed to deal with a very different economic context than the one that exists today cannot be functional anymore. Therefore, a moderation of the view of these organisations, which resist in the delivery of new rules particularly addressed to the needs of the digital economy, is considered as necessary.

Finally, it should be remembered that the BEPS project is being criticised as ambitious both in terms of substance and timing. Should this project fail, the comments regarding the use of the profit split and the findings regarding intangibles in Discussion Draft 10 and Actions 8 - 10 should not be disregarded. Likewise, the way forward that was delivered in this paper should be taken into account. As all these three works mainly urge for modifications of the current transfer pricing rules, they should not be treated only as a possible consideration for the BEPS project, but as a general stimulation for the Guidelines.