Transfer Pricing Forum

Transfer Pricing for the International Practitioner

Services or Intangible Property Transfer? – Senior Technical & Management Personnel Transfers

Services or Intangible Property

1. If a senior manager or management team is relocated into or out of your jurisdiction, does your country have a view about whether the transfer is purely a services transfer, or includes an intangible asset such as goodwill (or even workforce in place); or of an intangible such as profit potential?
2. What factors would be considered to determine how to characterize this transfer? In particular, might it make a difference whether it is a single person or a group of managers?
3. What difference might the duties of the management team make? (For example, suppose this was a sales person or team, as opposed to a management team? Or an R&D group?)

Valuing the Item Transferred

1. Are there any local tax or valuations rules or conventions on such valuations? How would the Hard-To-Value Intangibles concepts apply?

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Introduction

The UK transfer pricing position on the transfer of senior teams stems from Part 4 of the Taxation (International and Other Provisions) Act (***TIOPA***) 2010. This Act aims to ensure that connected parties transacting between themselves do not obtain a tax advantage by setting prices that would not be available from unconnected parties on the open market (i.e. prices that are not "at arm's length"). Part 4 of TIOPA 2010 applies where a basic pre-condition is satisfied and an actual provision confers a potential UK tax advantage.[1] The basic pre-condition requires that an actual provision is made or imposed between any two affected persons by means of a transaction (or series of transactions),[2] such persons are under common control or management and the provision differs from that which would have been made between independent enterprises (in other words, an arm's length provision).[3] The profits and losses of the advantaged person(s) are then calculated as if the arm's length provision had been made or imposed instead of the actual provision in place.[4]

Part 4 of TIOPA 2010 is to be read consistently with the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the ***OECD Guidelines***) published by the Organisation for Economic Co-operation and Development (***OECD***), as well as the arm's length principle set out in Article 9 of the OECD Model Tax Convention on Income and on Capital (***Article 9***).[5] Further guidance is set out in HMRC's International Manual.[6] Although not binding on taxpayers, HMRC will normally expect to apply the interpretations and policies set out in this manual.

The transfer of a senior manager or management team might conceivably result in a transfer of goodwill and potentially an entitlement to the returns of other existing or future intangibles. The analysis is likely to differ according to the value that would be placed on a particular senior manager or management team and whether an independent third party would remunerate that particular transfer.

It is likely that the UK would not regard the transfer of a "workforce in place" as entailing, by itself, the disposal of an asset. The effect of this transfer in enhancing the value of any other transferred asset, on the other hand, might be recognised and need to be remunerated appropriately where it results in the transfer of know-how or another intangible. The OECD Guidelines also note that business restructurings involving the transfer of an ongoing concern, such as research facilities operated by an experienced research team, should be valued in order to reflect the value of the facility and the impact of that assembled workforce on the arm's length price.[7]

Profit potential is not recognised as an intangible asset in the OECD Guidelines. There is no UK requirement to compensate the value of transferred profit potential, beyond the extent of paying for any underlying assets which have been transferred or services provided.

Part 8 of the Corporation Tax Act (***CTA***) 2009 sets out provisions on the tax treatment of intangible fixed assets (or at least, generally speaking, those created since 2002), including the taxable income or deduction that will result on a transfer. These provisions are drafted on the basis that the transfer pricing rules in Part 4 of TIOPA 2010 apply to transactions within Part 8 CTA 2009. Further, Chapter VI of the OECD Guidelines sets out a presumptive *ex post* mechanism for the valuation of Hard-to-Value Intangibles which may, in certain circumstances, be relevant to the transfer of a senior manager or management team where this entails the transfer of intangibles.[8]

The taxpayer should assemble sufficient documentation at the time of the transfer to support the valuation of any transferred asset. This is likely to include support for assumptions concerning future cash flows and the risk(s) attached to the same.

Services or Intangible Property

1. If a senior manager or management team is relocated into or out of your jurisdiction, does your country have a view about whether the transfer is purely a services transfer, or includes an intangible asset such as goodwill (or even workforce in place); or of an intangible such as profit potential?

As noted above, a "provision" is required in order for Part 4 of TIOPA and the associated materials to apply. HMRC's International Manual notes that "provision" is not defined in Part 4 of TIOPA 2010; however, it is broadly equivalent to the phrase "*conditions made or imposed between two [associated] companies*" in Article 9(1) of the OECD Model Tax Convention. Further, a "condition" in Article 9 is not restricted to formal or enforceable arrangements and therefore encompasses all terms and conditions attaching to a transaction or series of transactions. This point was made in *DSG Retail Ltd v Revenue and Customs Commissioner*s where the Special Commissioners stated that a "provision" may be made by means of informal arrangements or understandings.[9] This interpretation is supported by the legislative requirement to read Part 4 of TIOPA 2010 in a manner consistent with the OECD Guidelines.[10]

The relocation of a senior manager or management team can therefore fall within the transfer pricing rules where it entails a condition made or imposed between two associated companies. The transfer need not be a formal or enforceable arrangement, but will be analysed by reference to the actual facts and circumstances in hand. We also note that, where a company provides services involving the transfer of a senior manager or management team which are of a temporary or transient nature, this will be characterised as a "provision" of services. Should this be the case, guidance can be found in Chapter VII of the OECD Guidelines and the International Manual.[11]

Goodwill

Chapter VI of the OECD Guidelines addresses intangibles for the purposes of transfer pricing. An intangible is defined as something which is not a physical or financial asset, 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.[12] Whether the transfer of an intangible would be compensated therefore depends on the specific intangible and its worth. HMRC's guidance also asks whether the intangible property would be worth anything at arm's length and, if so, whether an independent party would pay to use it (or charge another to do so).[13]

Whether the transfer of a senior manager or management team includes an intangible asset such as goodwill is not addressed directly in HMRC's transfer pricing guidance; however, the International Manual states that:

"*Importantly, it will be the goodwill or reputation of the relevant business, product or service which gives the trade mark or name its apparent value and it is not necessarily the case that the party which owns the registration of the trade mark in a particular territory also owns the goodwill or reputation in that territory. A licence of a trade mark at arm's length is implicitly also a licence of the goodwill or reputation associated with that trade mark as ownership of the different intangibles is rarely separated. In group situations, however, it might be that the trade mark is registered with a party other than that which has carried on the business that has produced the goodwill or reputation (and consequently owns that goodwill or reputation) which gives the trade mark its apparent value. It would not be appropriate for a significant payment to be made in such circumstances to the party which owns only the trade mark or name but not the associated intangibles*."[14]

If the reputation and goodwill of the business is attached in some way to an individual or team (perhaps because particular individuals hold key customer relationships), their transfer to a different entity may reduce the goodwill of the transferor business and thus result in a transfer of value.

UK tax law recognises the possibility of a disposal of goodwill, although it is generally recognised that goodwill cannot be segregated or transferred separately from other business assets.[15] Part 8 CTA 2009 includes provisions concerning the realisation of goodwill.[16] Here, goodwill is given the same meaning as used for accounting purposes.[17] However, the OECD Guidelines note that intangibles considered for transfer pricing purposes are not always those recognised as such for accounting purposes.[18] In addition, goodwill can be used to refer to a number of different concepts, including the future economic benefits associated with business assets that are not individually identified and separately recognised.[19]

There is no statutory definition of goodwill, and the concept is not straightforward. Case law, including the oft-quoted *Inland Revenue Commissioners v Muller & Co Margarine Limited*, has offered various interpretations. [20] Goodwill was defined there as "*the benefit and advantage of the good name, reputation and connection of a business*". This includes "*whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers and agreed absence from competition*".[21] This case was cited in *Kirby (Inspector of Taxes) v Thorn E.M.I. Plc*, where Nicholls L.J. reiterated that reputation is a form of goodwill and has a value.[22]

In *R J Reuter Co Ltd v Mulhens* the court held that goodwill represents the value of the attraction to customers which the name and reputation of a business or business product possesses.[23] More recently, *Brit-*

ish Broadcasting Corporation v Talksport Ltd noted that words which are merely descriptive of a service cannot create goodwill.[24]

HMRC have made reference to *Whiteman Smith Motor Co v Chaplin* when identifying goodwill for tax purposes.[25] This case set out the following classes of goodwill:

(a) customers who stay faithful to the location, not the person;

(b) customers who stay faithful to the person, not the location;

(c) customers who are attracted by neither person nor location; and

(d) customers who use the service because it is convenient and for no other reason.[26]

These distinctions could be interpreted, more practically, as the following categories of goodwill:

(a) inherent – the goodwill attaching to the property by virtue of its location;

(b) personal – related to the skills and personality of the proprietor, e.g. a chef or hairdresser; and

(c) free – related to the overall worth of the business, which can be split into

(i) adherent; and

(ii) separable[27].

Adherent goodwill is defined in HMRC's Capital Gains Manual as goodwill which does not arise from the locational advantages, but from the carrying on of a particular business for which those premises have been or are specially adapted or licensed. Separable goodwill is defined as the true free goodwill generated independently from the premises. In practice, the distinctions between inherent, adherent and free are no longer really applied given that inherent and adherent should be included in the underlying value of the business asset.

It follows that goodwill attaching to a senior manager or management team may be more easily identifiable where customers cease to buy from the transferor business due to an appreciation of the intangible assets that may have transferred with this manager or team. Business customers or high net worth investors for instance may be more alert to the worth of a senior manager or management team, and certain highly-skilled individuals in professional services (including those not in the position of senior manager) may also hold significant and separately identifiable value.

Workforce in Place

The concept of a workforce in place is not specifically addressed in HMRC's International Manual. However, the OECD Guidelines state as follows:

"Some businesses are successful in assembling a uniquely qualified or experienced cadre of employees. The existence of such an employee group may affect the arm's length price for services provided by the employee group or the efficiency with which services are provided or goods produced by the enterprise. Such factors should ordinarily be taken into account in a transfer pricing comparability analysis. Where it is possible to determine the benefits or detriments of a unique assembled workforce vis-à- vis the workforce of enterprises engaging in potentially comparable transactions, comparability adjustments may be made to reflect the impact of the assembled workforce on arm's length prices for goods or services.

In some business restructuring and similar transactions, it may be the case that an assembled workforce is transferred from one associated enterprise to another as part of the transaction. In such circumstances, it may well be that the transfer of the assembled workforce along with other transferred assets of the business will save the transferee the time and expense of hiring and training a new workforce. Depending on the transfer pricing methods used to evaluate the overall transaction, it may be appropriate in such cases to reflect such time and expense savings in the form of comparability adjustments to the arm's length price otherwise charged with respect to the transferred assets. In other situations, the transfer of the assembled workforce may result in limitations on the transferee's flexibility in structuring business operations and create potential liabilities if workers are terminated. In such cases it may be appropriate for the compensation paid in connection with the restructuring to reflect the potential future liabilities and limitations.

The foregoing paragraph is not intended to suggest that transfersor secondments of individual employees between members of an MNE group should be separately compensated as a general matter. In many instances the transfer of individual employees between associated enterprises will not give rise to a need for compensation. Where employees are seconded (i.e. they remain on the transferor's payroll but work for the transferee), in many cases the appropriate arm's length compensation for the services of the seconded employees in question will be the only payment required.

It should be noted, however, that in some situations, the transfer or secondment of one or more employees may, depending on the facts and circumstances, result in the transfer of valuable know-how or other intangibles from one associated enterprise to another. For example, an employee of Company A seconded to Company B may have knowledge of a secret formula owned by Company A and may make that secret formula available to Company B for use in its commercial operations. Similarly, employees of Company A seconded to Company B to assist with a factory start-up may make Company A manufacturing know-how available to Company B for use in its commercial operations. Where such a provision of know-how or other intangibles results from the transfer or secondment of employees, it should be separately analysed under the provisions of Chapter VI and an appropriate price should be paid for the right to use the intangibles.

Moreover, it should also be noted that access to an assembled workforce with particular skills and experience may, in some circumstances, enhance the value of transferred intangibles or other assets, even where the employees making up the workforce are not transferred. Example 23 in the Annex to Chapter VI illustrates one fact pattern where the interaction between intangibles and access to an assembled workforce may be important in a transfer pricing analysis."[28]

The example referred to in paragraph 1.156 above concerns a situation in which the price paid for an acquired company:

"is justified primarily by the value of the promising, but only partly developed, technologies and by the potential of Company T personnel to develop further new technologies in the future."

The relevant intangibles are transferred to another Company (S), which pays Company T's personnel for their ongoing research. According to the OECD Guidelines:

"*Depending on the facts, some portion of the value described in the purchase price allocation as goodwill may also have been retained by Company T*."[29]

From this discussion, it is possible to draw the following conclusions about the UK's likely approach to the transfer of a workforce in place:

(a) it would not necessarily have separate value in itself;

(b) its effect of enhancing the value of any other transferred asset should be recognised; and

(c) where it results in the transfer of know-how (or some other intangible), this should be remunerated appropriately.

One can imagine situations where the transfer of highly-skilled employees justifies or commands a "transfer fee". The question arises as to what exactly is being transferred. This may be the benefit of the relevant employment contracts (particularly where the individuals generate value for the business in excess of their remuneration) combined with a willingness to remain with the business. The latter is included given that, in principle, most employees can choose to leave at will but tend not to do so ("stickiness").

The OECD Guidelines continue as follows:

"*Assume that several employees of M1 are relocated to M2 in order to assist M2 in the start of the manufacturing activity so relocated. Assume such a transfer would be regarded as a transfer of an ongoing concern, should it take place between independent parties. In order to determine the arm's length remuneration, if any, of such a transfer between associated enterprises, it should be compared with a transfer of an on going concern between independent parties rather than with a transfer of isolated assets*."[30]

Thus, if the management team are transferred at the same time as an asset or assets, the effect could be that the whole should be valued as the transfer of a going concern. Further, the OECD Guidelines state that business restructurings involving the transfer of an ongoing concern, such as research facilities operated by an experienced research team, should be valued in order to reflect the value of the facility and the impact of that assembled workforce on the arm's length price.[31]

Wider guidance on this issue can be found in the context of financial reporting. Here, an assembled workforce is frequently valued as part of a purchase price allocation (***PPA***) exercise for International Financial Reporting Standard 3: Business Combinations. While International Accounting Standard 38 specifies that the fair value of the assembled workforce should not be recognised as a separate intangible asset apart from goodwill, the value of an assembled workforce can have an effect on the value attributable to certain other intangible assets and therefore does typically need to be valued. This is similar to the suggestion in the OECD Guidelines that the existence of a workforce in place should be viewed as a comparability factor.

In a PPA, a Cost Savings Method is typically used to value the assembled workforce. This takes into account the cost to recruit and train an entirely new workforce. The value of the current workforce is therefore based on the costs saved by avoiding the need to recruit and train an equivalent workforce with the same skills and to the same level of efficiency. This is usually calculated by estimating the recruitment cost for hiring people at a similar level. Additionally, it is assumed that a new employee is less productive compared to an employee who has been in the relevant position for some time. Therefore, an estimate is made of the level of efficiency when the new employee starts compared to a fully-efficient equivalent and the number of months that it will take for the new employee to reach full efficiency. The salary costs wasted during this period are added to the recruitment costs in order to determine the value of the existing workforce. This is equivalent to the total cost saved by avoiding the need to recruit new employees.

This approach does not take into account any unique skills of senior management, key R&D or marketing staff and therefore does not seek to capture any major impact on the business (such as losing key sales contracts or the inability to innovate due to the loss of key R&D teams). If such losses are expected, then a "with or without" analysis may be more appropriate. As the name suggests, this analysis seeks to compare two scenarios: one in which the key staff to be valued are part of the business, and the second in which the key staff are not part of the business. The difference between the two scenarios can be quantified and used as an indication of the value of the employees.

Therefore, this financial reporting approach could potentially be used to calculate the size of the comparability adjustment required for a workforce in place in a transfer pricing valuation.

Profit Potential

The concept of "profit potential", according to the OECD Guidelines, means "expected future profits" and may, in some cases, encompass losses. The concept is often used for valuation purposes in determining an arm's length compensation for a transfer of intangibles or of an ongoing concern. It may also be used to determine an arm's length indemnification for determination or substantial renegotiation of existing arrangements, once it is found that such compensation or indemnification would have taken place between independent parties in comparable circumstances.[32] The OECD Guidelines also note that:

"*An independent enterprise does not necessarily receive compensation when a change in its business arrangements results in a reduction in its profit potential or expected future profits. The arm's length principle does not require compensation for a mere decrease in the expectation of an entity's future profits. When applying the arm's length principle to business restructurings, the question is whether there is a transfer of something of value (an asset or an ongoing concern) or a termination or substantial renegotiation of existing arrangements and that transfer, termination or substantial renegotiation would be compensated between independent parties in comparable circumstances*."[33]

Profit potential is not recognised as an intangible in the OECD Guidelines.[34] As Part 4 of TIOPA 2010 is to be read consistently with these guidelines, the UK tax system will not seek to treat the relocation of a senior manager or management team as entailing the transfer of an intangible asset comprising profit potential.

Rather, "profit potential" may be regarded as a measure of the value of an asset, particularly relevant when it is valued using an income method.

Capital Gains

It is also noteworthy that Part 4 of TIOPA 2010 does not apply to the calculation of a chargeable gain (or allowable loss).[35] This is discussed further at Part II below.

2. What factors would be considered to determine how to characterize this transfer? In particular, might it make a difference whether it is a single person or a group of managers?

As noted above, Part 8 CTA 2009 sets out the modern UK tax regime for intangible fixed assets. An intangible fixed asset is realised when, in accordance with generally accepted accounting practice, it is no longer reflected on the company's balance sheet or its accounting value is reduced.[36] Where the asset is internally generated and therefore not recognised on the balance sheet, the realisation will occur when there is a transaction which, if the asset did have a balance sheet value, would have resulted in the asset ceasing to be recognised on the balance sheet or reduced the accounting value of that asset.[37]

This leads to the question of whether value would be placed on the transfer and whether an independent party would have remunerated this transfer (such that the actual provision could differ from the arm's length provision). As noted in the OECD Guidelines, this requires identification of the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those.[38] Where intangibles are transferred between associated enterprises, it is necessary to identify the nature of and rights in these intangibles.[39] Where a business restructuring is involved, this will also involve analysis of the two associated entities' ongoing businesses after the restructuring has taken place.[40]

Following the discussion of goodwill potentially attaching to a senior management team above, it is conceivable that a single person could also attract goodwill (for example, an individual with important and valuable customer relationships). Similarly, as noted above, valuable know-how may reside within particular individuals. It may be the case that, where a single person as opposed to a team is relocated, an independent party would not have remunerated that particular transfer. However, this will be specific to the facts and circumstances of the individual transfer. Where for example a pharmaceutical laboratory team is relocated as compared to an individual accountant, the worth of that laboratory team may be significant due to the combined amount of its expertise. In this scenario it is more likely that the transfer would provide a commercial benefit to the receiving entity and that a third party would have been willing to pay for that transfer.

3. What difference might the duties of the management team make? (For example, suppose this was a sales person or team, as opposed to a management team? Or an R&D group?)

To the extent that a management team was closely involved in the sales process in a manner which was visible to the company's customers, the analysis above would suggest that some goodwill could attach to that team in a way that might not arise if the activities of the team were less externally evident. On the other hand, informed business customers who sought out the company for its special technology might place greater worth on a team who functioned as the core R&D team. In the latter case, that R&D team could be a valuable workforce in place.

If the R&D team were involved in making key intangible asset Development, Enhancement, Management, Protection and Exploitation (***DEMPE***) function decisions, and would continue to do so after being transferred, the transferee entity's entitlement to the intangible-related returns would need to be recognised either through the subsequent ongoing transfer pricing arrangements, any lump sum payment at the point of transfer (potentially by reference to the approach to Hard-to-Value Intangibles, on which see the discussion below) or both.

Put simply, the duties of a team will impact on the value that they provide to the business. In turn, this will affect the arm's length price and whether an independent party would have provided remuneration for the transfer of that particular team. In the case of an R&D group, the OECD Guidelines note that appropriate compensation for research services will depend on all the facts and circumstances of the transfer. This includes whether the research team possesses unique skills and experience relevant to the research, assumes risks, uses its own intangibles, or is controlled and managed by another party.[41] The value of the group and the arm's length price payable for its transfer will depend on such factors.

Valuing the Item Transferred

1. Are there any local tax or valuations rules or conventions on such valuations? How would the Hard-To-Value Intangibles concepts apply?

Valuations

It is critical to analyse the precise nature of what is being transferred before determining how to value that particular transfer. The realisation of an intangible fixed asset (or at least those which, broadly speaking, were created since 2002) will lead to a tax charge or deduction under the intangible fixed assets regime, as set out in Chapter 4, Part 8 CTA 2009.[42] Depending on the nature of the intangible asset realised, this charge or deduction will be a trading or non-trading debit or credit. Chapter 4 provides that the difference between the realisation proceeds and the tax written down value of the intangible asset immediately before realisation is brought into account for tax purposes. The resultant tax charge or deduction will then depend on whether these proceeds exceed or fall below that tax written down value.[43]

In general, for capital assets, section 17 of the Taxation of Chargeable Gains Act (***TCGA***) 1992 provides that asset disposals and acquisitions made otherwise than by way of a bargain at arm's length (which is deemed to be the case by section 18 TCGA 1992 for connected party transactions) are treated as made at market value. In particular, this applies where an asset is disposed of wholly or partly for a consideration that cannot be valued, or in consideration for or recognition of services or past services in any office or employment (or of any other service rendered or to be rendered).[44] However, for intangible assets the provisions of Part 8 CTA 2009, where applicable, take priority and, even for assets that would ordinarily be viewed as capital, impose the revenue account basis of taxation described above for intangible fixed assets arising since 2002.

HMRC also note that Part 8 CTA 2009 overrides general computational rules and takes precedence over other corporation tax legislation.[45] However, the transfer pricing provisions set out in Part 4 of TIOPA 2010 are expressed in terms of the computation of profits and losses, rather than by reference to specific items of income or expenditure. As a result these provisions are not overridden and no special provision is needed to ensure that Part 4 of TIOPA 2010 applies to transactions within Part 8 CTA 2009. Part 8 is therefore drafted on the basis that transfer pricing rules do apply to these transactions.[46]

Hard-to-Value Intangibles

As noted above, Part 4 of TIOPA 2010 is to be read consistently with the OECD Guidelines and, since the incorporation of the BEPS outcomes, the provisions for valuations therein, including those on Hard-to-Value Intangibles. Chapter VI of the OECD Guidelines states that such intangibles arise where:

(a) no reliable comparables exist; and

(b) at the time the transaction was entered into, the projections of future cash flows or income expected to be derived, or the assumptions used to value the intangible, were highly uncertain.[47]

The chapter goes on to set out a proposed valuation for Hard-To-Value Intangibles whereby *ex post* outcomes provide presumptive evidence on the reasonableness of the projections used on an *ex ante* basis in order to determine the pricing of a transaction.[48] This presumptive evidence can be rebutted if it is demonstrated that it does not affect the accurate determination of the arm's length price.[49]

HMRC's guidance on the valuation of intangibles in turn draws on the OECD Guidelines and states that:

"Where a transaction between associated parties involves a hard to value intangible and none of the exemptions apply, 'ex post' outcomes can be considered by HMRC as presumptive evidence regarding the appropriateness of the 'ex ante' pricing arrangements, the reasonableness of the assumptions used in determining those arrangements and, consequently, the extent to which they comply with the arm's length principle.

Such consideration can include the structure of the arrangements including any contingent pricing arrangements that might have been entered into at arm's length. It might be appropriate in some cases to undertake a multi-year analysis."[50]

The exemptions referenced above are as follows:

"the MNE group provides:

1. details of the projections used at the time of the transaction to determine the pricing arrangements, including risk-weightings or adjustments used and how the appropriateness of these was determined; and,

2. reliable evidence that any significant difference between the financial projections and actual outcomes is due to either (a) unforeseeable developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction; or (b) the playing out of probability of occurrence of foreseeable outcomes, and that these probabilities were not significantly overestimated or underestimated at the time of the transaction; or

the transfer of the HTVI is covered by a bilateral or multilateral advance pricing arrangement in effect for the period in question which covers the transaction in question; or

any significant difference between the financial projections and actual outcomes does not have the effect of reducing or increasing the compensation for the HTVI by more than 20% of the compensation projected at the time of the transaction; or

a commercialisation period of five years has passed following the year in which the HTVI first generated unrelated party revenues for the transferee and in which commercialisation period any significant difference between the financial projections and actual outcomes was not greater than 20% of the projections for that period."[51]

HMRC also note the following situations in which Hard-to-Value Intangibles are likely to arise:

(a) the intangible is only partially developed at the time of the transfer;

(b) the intangible is not expected to be exploited commercially until several years following the transaction;

(c) the intangible does not itself fall within the definition of Hard-to-Value Intangible but is integral to the development or enhancement of other intangibles which does fall within that definition;

(d) the intangible is expected to be exploited in a manner that is novel at the time of the transfer and the absence of a track record of development or exploitation of similar intangibles makes projections highly uncertain; or

(e) the intangible is either used in connection with, or developed under, a Cost Contribution Agreement.[52]

In light of the above, it is possible that intangibles associated with the transfer of a senior manager or management team could fall within the Hard-to-Value Intangibles rules where, at the time of the transfer, there were:

(a) no reliable comparables;

(b) uncertain projections of future cash flows;

(c) uncertainties over the expected income; or

(d) uncertainties over the assumptions used to value the transfer.

In such a scenario, the OECD Guidelines state that outcomes following the transfer may then be used to test whether projections used at the time to value the transfer were reasonable and the price paid was therefore at arm's length.

Supporting the Company Position

1. What features does a transfer pricing policy need, in order to use it to support a calculation of this value reliably (given that the management team provides current services but may also be involved in important intangible asset DEMPE decisions)?

HMRC do not prescribe any specific documentation for the transfer of a team of people, and as such the guidance on business restructurings contained in the OECD Guidelines would be referred to. This states that:

"As part of their transfer pricing documentation, MNE groups are recommended to document their decisions and intentions regarding business restructurings, especially as regards their decisions to assume or transfer significant risks, before the relevant transactions occur, and to document the evaluation of the consequences on profit potential of significant risk allocations resulting from the restructuring. In describing the assumption of risk as part of business restructuring, it is recommended that taxpayers use the framework set out in Section D.1.2.1 of Chapter I."[53]

The relevant documentation for valuing an asset transferred as part of the relocation of a senior manager or management team, and in particular a Hard-to-Value Intangible, would depend on the valuation method selected. Where income-based methods involving estimations of discounted cash flows are used, the OECD Guidelines note that assumptions on the following inputs are required:[54]

(a) realistic and reliable financial projections;

(b) growth rates;

(c) discount rates;

(d) the useful life of the intangible

(e) taxes on future revenue, tax amortisation benefits available to the acquirer and taxes on the sale proceeds; and

(f) terminal values (where appropriate) - that is, ongoing contributions to revenue after the forecasting period.

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NOTES

[1] Sections 147(2)(a)-(b) and 147(4)(b) TIOPA 2010. A potential tax advantage is defined in section 155(2)-(4) TIOPA 2010 as a reduction in taxable profits for a chargeable period or the creation or increase of tax losses for a chargeable period due to the fact that a provision was not at arm's length.

[2] A "transaction" is defined in section 150(1) TIOPA 2010 to include arrangements, understandings and mutual practices (whether or not they are (or are intended to be) legally enforceable). Section 150(5) TIOPA 2010 notes that an "arrangement" means any scheme or arrangement of any kind (whether or not it is (or is intended to be) legally enforceable). Under section 150(3)-(4) TIOPA 2010, a "series of transactions" can still give rise to a provision even where there are one or more transactions in the series to which neither person is a party, or no transactions to which both are parties.

[3] Sections 147(1)(a), 147(1)(b) 147(1)(d) and 148 TIOPA 2010. The requirement for common control or management is set out in section 148 TIOPA 2010. This requirement is met when one of the two affected persons directly or indirectly participated in the management, control or capital or the other, or a third person participated in the management, control or capital of both affected persons.

[4] Sections 147(3) and (5) TIOPA 2010. These rules apply to both cross-border and UK-UK provisions.

[5] Section 164(1) TIOPA 2010. The latest version of the OECD Guidelines, released on 10 July 2017, reflects clarifications and revisions made as part of the OECD's Base Erosion and Profit Shifting project (***BEPS***). In particular, these relate to BEPS Actions 8-10 on Aligning Transfer Pricing Outcomes with Value Creation as agreed in the October 2015 BEPS Reports. The definition of transfer pricing guidelines in section 164 TIOPA 2010 requires updating to incorporate the revised, consolidated OECD Guidelines published in 2017. We are aware that HMRC are preparing a Statutory Instrument to address this point.

[6] INTM410000 to INTM489000.

[7] OECD Guidelines, Chapter IX, Section E.3.1, paragraph 9.68.

[8] OECD Guidelines, Chapter VI, Section D.4, paragraph 6.188.

[9] [2009] UKFTT 31 (TC). The Special Commissioners noted that this was due to the obligation to construe the legislation in such manner as best ensures consistency with the OECD model.

[10] INTM412050 and section 164(1) TIOPA 2010.

[11] From INTM440060.

[12] OECD Guidelines, Chapter VI, Section A.1, paragraph 6.6.

[13] INTM440110.

[14] INTM440140.

[15] Ibid. Lord Lindley in *IRC v Muller & Co Margarine Limited* noted at [235] that *"goodwill is inseparable from the business to which it adds value"*.

[16] Chapter 4, Part 8, Corporation Tax Act (***CTA***) 2009. Note that section 715(1) CTA 2009 states Part 8 CTA 2009 applies to goodwill as it applies to an intangible fixed asset.

[17] Section 715(3) CTA 2009. The definition of goodwill here includes internally-generated goodwill. Section 715(1) CTA 2009 notes that Part 8 applies to goodwill as it applies to an intangible fixed asset.

[18] OECD Guidelines, Chapter VI, Section A.1, paragraph 6.7.

[19] OECD Guidelines, Chapter VI, Section A.4.6, paragraph 6.27.

[20] [1901] A.C. 217.

[21] This case was also cited in *Breyer Group Plc v Department of Energy and Climate Change* [2014] EWHC 2247 (QB) at [68].

[22] [1988] 1. W.L.R. 445.

[23] [1954] Ch 50.

[24] [2001] FSR 53. Selected further case law discussing goodwill includes *Kennedy v Lee* [1817] 3 Mer 441 at [452], *England v Downs* [1842] 6 Beav 269 at [276], *Potter v IRC* [1854] 10 Exch 147 at [157], *Wedderburn v Wedderburn (No 4)* [1856] 22 Beav at [104], *Churton v Douglas* [1859] John 174, *Ginesi v Cooper & Co* [1880] 14 Ch D 596 at [600], *Trego v Hunt* [1896] AC 7 at [16]-[17], *Hill v Fearis* [1905] 1 Ch 466 at [471], *Corbin v Stewart* [1911] 28 TLR 99, *Shaw Bros (Hong Kong) Ltd v Golden Harvest (HK) Ltd* [1972] RPC 559, *H P Bulmer Ltd and Showerings Ltd v J Bollinger SA and Champagne Landon Pere et Fils* [1977] 2 CMLR 625 and *Shelley v Cunane* [1983] FSR 390.

[25] [1934] 2 KB 35.

[26] These four elements of goodwill are discussed in *Whiteman Smith Motor Co v Chaplin* by reference to a cat, rat, dog and rabbit. The cat represents customers who continue to go to an old shop despite the fact that the old shopkeeper has gone, the dog represents customers who follow the person rather than the place, the rat represents the customer who follows neither place nor person and the rabbit represents the customers who come simply from propinquity to the premises. The first three analogies appear to stem from a book published by the counsel in this case, Mr SPJ Merlin, whilst the rabbit analogy was introduced by Maugham LJ in this case. The analogies were later picked up on in *FC of T v Williamson* [1943] HC 24 and *Kirby (Inspector of Taxes) v Thorn E.M.I.*[1988] 1. W.L.R. 445.

[27] *Goodwill Hunting*, Jenny Nelder, Taxation, 22 October 2008.

[28] OECD Guidelines, Chapter 1, Section D.7, paragraphs 1.152 - 1.156.

[29] OECD Guidelines, Annex to Chapter VI, Example 23.

[30] OECD Guidelines, Chapter IX, Section E.3.1, paragraph 9.70.

[31] OECD Guidelines, Chapter IX, Section E.3.1, paragraph 9.68.

[32] OECD Guidelines, Chapter IX, Section D.1, paragraph 9.40.

[33] OECD Guidelines, Chapter IX, Section D.1, paragraph 9.39.

[34] There is no reference to profit potential in the context of an intangible within Chapter VI of the OECD Guidelines.

[35] Sections 147(6)(c)-(d), 213 and 214 TIOPA 2010.

[36] Section 734(1)(a)-(b) CTA 2009.

[37] Section 734(3) CTA 2009.

[38] OECD Guidelines, Chapter 1, Section D.1, paragraph 1.33.

[39] OECD Guidelines, Chapter VI, Section C.1.1, paragraph 6.89.

[40] OECD Guidelines, Chapter IX, Section B.1, paragraph 9.18.

[41] OECD Guidelines, Chapter VI, Section B.4.2, paragraph 6.79.

[42] Sections 733-741 CTA 2009.

[43] Section 735 CTA 2009.

[44] Section 17(1)(b) TCGA 1992.

[45] CIRD10110.

[46] CIRD47060.

[47] OECD Guidelines, Chapter VI, Section D.4, paragraph 6.189.

[48] OECD Guidelines, Chapter VI, Section D.4, paragraph 6.188.

[49] Ibid.

[50] INTM440176.

[51] Ibid.

[52] INTM440176.

[53] OECD Guidelines, Chapter IX, Section B.4, paragraph 9.33.

[54] OECD Guidelines, Chapter VI, Section D.2.6.3, paragraph 6.157.