

Law and economics

Changes in domestic and international transfer pricing law have placed a greater emphasis on economic analysis and legal expertise, explain **Danny Beeton, Murray Clayson** and **Justin Watts** of Freshfields Bruckhaus Deringer LLP



National tax authorities have long been preoccupied by the belief that transfer pricing rules could be manipulated by multinational enterprises in such a way as to leave more profit in lower tax rate jurisdictions. Transfer pricing relates to the value placed on assets or goods moved from one subsidiary to another within a multinational. Often this takes place across international borders.

Of course, it is for businesses to organise their affairs across national boundaries as they choose, but where disputes with tax authorities arise it is frequently the role of economists to confirm whether a company's cross-border agreements are weighted fairly.

In order to assess this, much transfer pricing work now focuses in particular on the issue of relative bargaining power and the rights created by ownership of intangible assets. Recent high-profile cases, such as *DSG Retail (Dixons) v HM Revenue &*

The 2009 case of DSG Retail highlighted the risks of current transfer pricing rules

Customs (HMRC) in the UK, have been determined on fine points of law and the testimony of expert economists. HMRC has recruited its own core of transfer pricing economists to assist in increasingly complex disputes, while international bodies such as the Organisation for Economic Cooperation and Development (OECD) and the European Union are reviewing their guidance on transfer pricing on the basis of many economists' submissions.

Power plays

Lee Corrick, assistant director and head of transfer pricing at HMRC, told the OECD business restructurings meeting in June 2009 that, in HMRC's view, the bargaining power of relevant parties was a key element in determining the transfer pricing 'method' and the price itself. For example, he said that the question of whether compensation is

due to a subsidiary in a multinational company that has been restructured should be resolved by answering the question: 'given its relative bargaining power, could it have negotiated a better deal?' That question will need to be answered by a combination of economists and, in many cases, intellectual property (IP) lawyers. However, this puts increased pressure on multinational companies which now need to chart their way through ever-more detailed, often conflicting, international transfer pricing rules, and then defend their pricing from more expert economic challenges. Legal expertise, especially in IP law, can complement economic analysis by providing companies with transfer pricing support.

Transfer pricing is a natural extension of the tax advice law firms are already giving to corporate clients in the areas of mergers and acquisitions, IP law and competition policy. But issues can also loom large in project areas, such as business restructurings (when IP Rights must be protected in situations of transfer, licensing or migration), fund advice (for example in relation to potential permanent establishments created by traders), advice on financing, banking and securities trading, and infrastructure and construction projects.

However, as with much of the practice of law, the starting point for any transfer pricing enquiry is the contractual framework in which it takes place, ie the agreements between the related parties. The tax authorities will compare those agreements against equivalents with or between independent parties in order to identify what would have been charged and what would be due as compensation had the agreements

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been made at 'arm's length'. Drafting the key clauses robustly in the first place – for example by outlining a company's rights over an intangible asset – is therefore crucial. So too is knowledge of the relevant jurisdictional frameworks; for instance, some of the UK's major trading partners, such as Germany, reserve the right to deny a tax deduction if it is not supported by the appropriate signed agreement.

In addition, in cases of business reorganisation, the input of IP lawyers will be necessary to bring added certainty to the valuation of the intangible assets that are being transferred, and to define exactly what is being, or indeed should be, transferred.

In case of dispute, litigation experts should be called in, especially in heavily fact-dependent scenarios when specialised document management systems, expertise in assembling evidence and dealing with witnesses come into their own. ■

