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INTANGIBLE ASSETS AND THEIR EMPLOYMENT IN TRANSFER PRICING TECHNIQUES

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ABSTRACT (ITALIAN)

Il presente elaborato ha come obiettivo l'analisi della stretta connessione emersa tra gli asset intangibili e le tecniche di elusione fiscale implementate da parte dei grandi gruppi multinazionali nel mondo. In particolare, negli ultimi anni, il crescente livello di globalizzazione dei business model aziendali, collegato ad un crescente utilizzo, da parte delle grandi imprese, di asset intangibili come fonte primaria di creazione di valore, ha messo in luce come tali organizzazioni sfruttino sempre più le lacune normative create dalla natura controversa ed elusiva degli intangibles per ridurre sostanzialmente il loro carico fiscale, così da ottimizzare la loro posizione finanziaria netta e massimizzare i profitti.

In principio, l'elaborato si occupa di introdurre il concetto di intangible assets, presentando una cronistoria che parte dall'origine della nozione stessa, per arrivare alle prime rilevazioni contabili nel Secondo dopoguerra. In seguito, si passa ad una dettagliata analisi dell'evoluzione normativa nel tempo, con l'obiettivo di approfondire come la crescente complessità del contesto economico internazionale abbia fatto luce sulla necessità di cooperazione internazionale tra le varie giurisdizioni nella redazione di principi contabili di globale applicazione. Dunque, dopo la presentazione delle varie associazioni internazionali che negli anni si sono mosse in questa direzione, si passa a definire il ruolo che gli intangible assets hanno avuto in questa transizione, tramite uno studio delle caratteristiche che li

differenziano dagli altri tipi di asset aziendali, per arrivare alle implicazioni che essi provocano per i sistemi contabili internazionali.

Successivamente, la parte centrale dell'elaborato ha l'obiettivo di introdurre la nozione di transfer pricing, analizzando in particolare in che modo le multinazionali facciano strategicamente leva sui transfer prices applicati per le transazioni infragruppo per muovere artificialmente parte dei loro profitti verso giurisdizioni a basso regime fiscale, minimizzando così il loro carico fiscale. Pertanto, ad un'introduzione teorica del concetto di transfer price segue lo studio delle implicazioni fiscali e normative che lo stesso ha prodotto negli anni, cui a sua volta segue un'analisi relativa alle azioni correttive intraprese da parte delle autorità normative (in particolar modo OECD) al fine di eliminare o, quantomeno, limitare, l'utilizzo strategico del transfer price per fini di elusione fiscale da parte dei grandi gruppi multinazionali.

In seguito, viene studiato nello specifico il ruolo che gli intangible assets ricoprono nelle strategie di elusione fiscale implementate dalle stesse imprese, partendo dalla significatività strategica di tali asset per arrivare alla complessità normativa che contribuiscono a incrementare. In particolare, vengono analizzate le Linee Guida OECD sul transfer pricing e il modo in cui le stesse sono state modificate nel tempo, adattandosi alla crescente complessità del contesto.

Infine, viene presentato e studiato un caso reale di elusione fiscale, il caso Inditex, al fine di comprendere nel concreto in che modo i grandi gruppi multinazionali

organizzano la propria struttura e le proprie operazioni in diversi paesi per ridurre il proprio carico fiscale, tramite lo spostamento artificiale di profitti in diverse giurisdizioni fiscali. Nel dettaglio, viene analizzato lo schema di elusione fiscale implementato da inditex nei Paesi Bassi, in quanto fondato sulla manipolazione delle royalties per l'utilizzo della proprietà intellettuale. Pertanto, tale schema permette di fare luce sul reale potenziale strategico degli asset intangibili (quali sono le royalties) e sulle modalità con cui le multinazionali se ne servono per ottimizzare la propria posizione fiscale.

Infine, l'elaborato si sofferma sulle implicazioni etiche e sociali provocate dall'elusione fiscale da parte di tali imprese, e in particolare sul costo sociale che questa genera e sul modo in cui ciò impatta sulla cosiddetta "tax morale" di individui e organizzazioni.

INTRODUCTION

The present work wants to analyze the strongly debated topic of Transfer Pricing (TP), with specific regard to its applications to Intangible Assets. The paper will, therefore, combine two complex subjects, both from a regulatory and practical perspectives. It will start with a deep analysis of the evolution of global accounting principles over time, with specific regard to *Intangibles*: they will be defined and classified, with a special focus on their accounting and fiscal implications. After that, the concept of Transfer Pricing will be presented and further studied relatively to its applications by Multinational Companies, in order to analyze its impact on Corporate Strategies. Thereafter, the connection arising within the two topics will be presented an studied, with the aim to understand what makes intangible assets so appetible for the implementation of tax avoidance strategies by Multinational Enterprises (MNEs, or Corporations, MNCs). In the end, a case study will be presented, introducing the practical framework put in place by large multinational group to reduce their tax liabilities, with the idea of going deep into the reality of tax avoidance through the exploitation of intangibles. The work will pose its focus on the reflections of the analyzed topics on regulation, and the responses by the Institutions: a strong emphasis will be put on the corrective actions undertaken and the regulatory reforms implemented, with specific reference to OECD Guidelines and their latest relevant update of 2022 (*Chapter 3*). This last aspect will close the

circle of the analysis: intangibles have created regulatory gaps, giving companies the opportunity to exploit those gaps to their advantage. The regulatory adaptation and corrective actions have the function to fill those gaps and promote a *fair game*. The work origins from the willingness of the candidate to shed light on an often-recurring phenomenon, tax avoidance, which has caused several damages to society, and to understand to what extent this phenomenon can be considered legal.

1. INTANGIBLE ASSETS: BACKGOUND, DEFINITION AND GROWING SIGNIFICANCE

The definition of Intangible Asset is provided by IFRS/IAS 38: "an identifiable, non-monetary asset without physical substance."[1]. The concept began to be recognized during the post-World War II era. In fact, in that period, aspects such as goodwill started to gain importance and to be registered into corporate balance sheets. However, those kinds of assets were treated arbitrarily, mainly because of the absence of consistent standards and practices to regulate them. In the present chapter an investigation will be conducted about the evolution over time of the normative context for accounting and reporting systems worldwide. Thereafter, the focus will shift to intangible assets, their characteristics, measurement, connected challenges, and growing significance for international business.

[1] International Financial Reporting Standards (IFRS) Foundation. *IAS 38 – Intangible Assets*. 2001

1.1.OVERVIEW AND BACKGROUND: FROM IAS TO IFRS

1.1.1. THE BIRTH OF IASC

As stated above, when intangible assets were first recognized, they were treated arbitrarily, implying high degrees of subjectivity, and thus resulting in relevant discrepancies in the measurement of similar assets across different entities.

History changed in 1973, with the institution of the International Accounting Standards Committee (IASC), an independent private-sector organization defined as a "body working to achieve uniformity in the accounting principles that are used by businesses and other organizations for financial reporting around the world."[2]

It was formed through an agreement between professional accountancy bodies from different countries. They will be presented in detail in the following table (*Tab. 1*).

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[2] TAMPLIN, T. *International Accounting Standards Committee (IASC)*. Finance Strategists, 2023.

Tab. 1: Members of IASC in its foundation in 1973.

Country	Member
Australia	The Institute of Chartered Accountants in Australia
	Australian society of accountants
Canada	Canadian Institute of Chartered Accountants
France	Order of Accounting Experts and Qualified Accountants
Germany	Institute of Auditors in Germany
	Chamber of Auditors
Japan	Japanese Institute of Certified Public Accountants
Mexico	Mexican Institute of Public Accountants
Netherlands	Netherlands Institute of Registered Auditors
United Kingdom & Ireland	Institute of Chartered Accountants in England and Wales
	Institute of Chartered Accountants of Scotland
	Institute of Chartered Accountants in Ireland
	Association of Certified Accountants
	Institute of Cost and Management Accountants
	Institute of Municipal Treasures and Accountants
United States of America	American Institute of Certified Public Accountants (AICPA)

Source: Oxford University Press[3]

[3] CAMFFERMAN, K.; ZEFF, S. A. *Financial reporting and global capital markets: A history of the international accounting standards committee, 1973-2000*. Oxford University Press, USA, 2007, p. 49.

1.1.2. IASC STRUCTURE AND MAIN FUNCTIONS

The main scope of the IASC was inevitably related to the stable growth in international business transactions: to address the need for reporting standards that were clear, transparent, and comparable across different countries. Those standards were called, indeed, the International Accounting Standards (IAS).

The system was based upon two main features: representation and cooperation. In fact, each country possessed a representation inside the Council, which had the role to take major decisions about policy and to set standards.

Therefore, IASC's task was not only to develop and to publish IAS, but also to guarantee that those standards would have been worldwide received, accepted, and adopted. In order to achieve that, some key activities need to be performed: first of all, it was necessary to encourage national accounting bodies to adhere IAS and to adopt them, or to converge their national standards with IAS.

Secondly, the need for guidance on the application of IAS arose. Since it was a completely new system, its framework needed to be explained and clarified trough interpretative publications by the organization.

Another key feature of IASC was cooperation, both among member countries and with other international organizations, such as the International Organization of Securities Commissions (IOSCO), defined as "the international body that brings together the world's securities regulators and is recognized as the global standard

setter for the securities sector"[4], and the World Bank. The aim of those kind of collaborations is to improve the consistency and quality of the reporting system.

1.1.3. THE IMPORTANCE OF IAS

As stated in the previous paragraph, the main reason for the relevance of International Accounting Standards was strictly related to globalization: the increasing number of connections between businesses located in different areas shed light on the need for a uniform system for financial reporting across Nations, one which could enhance comparability between different countries.

Moreover, IAS were intended to promote transparency in the production of financial statements, meaning for companies' balance sheets to be credible and truthful. This resulted into a growing confidence by worldwide investors and, therefore, in an increased number of foreign investments.

Another important implication for the implementation of IAS was surely the reduced complexity following the standardization of accounting reporting systems. This aspect favored both companies, making easier for them to redact their financial statements, and users (e.g. potential investors, authorities, stakeholders), in terms of a simpler and immediate understanding.

[4] https://www.iosco.org

Lastly, setting uniform accounting standards that enhance high-quality financial reporting, promoting accountability and transparency, also resulted into an improvement of corporate governance practices, intended as those practices implemented to direct and control a company. The requirements for accountability and transparency created the need for a more efficient control system and more efficient managerial practices.

1.1.4. BIRTH OF THE FASB

Another key step for achieving uniform accounting systems was the foundation of the Financial Accounting Standards Board (FASB) in USA, in 1972 (began operating in 1973). It is defined as "the independent, private- sector, not-for-profit organization based in Norwalk, Connecticut, that establishes financial accounting and reporting standards for public and private companies and not-for-profit organizations".[5] FASB mission was to provide, through the establishment of high-quality accounting standards, useful, high-quality information to investors and other users of financial statements. Those standards took the name of Generally Accepted Accounting Principles (GAAP).

[5] *https://www.fasb.org*

1.1.5. IASC AND FASB: SIMILARITIES AND DIFFERENCES

By combining the provided definitions of International Accounting Standards Committee (IASC) and Financial Accounting Standards Board (FASB), it is possible to spot a convergence about the general purpose of their work: to develop and enhance high-quality accounting standards for companies, in order to provide high-quality information to users. Nevertheless, the two differed for several aspects. The first difference area is related to the missions: IASC worked to achieve globally uniform accounting standards, whereas FASB set standards for financial reporting in the United States. Therefore, also the scale of operations was different: IASC mission, the worldwide adoption of IAS, was much broader, and so were the standards. On the other hand, GAAP were more detailed and specific principles, in response to the FASB mission: to provide useful information for better decision-making processes that could improve the efficiency of capital markets.

Another source of difference is the Board composition: IASC Board consisted in seventeen members with one vote each, working on part-time volunteer basis and maintaining their original employment positions. On the contrary, FASB Board was composed by seven full-time, independent members, who were asked to abandon their previous job position to favor independence and objectivity.

Even though, as said before, the scale of these two organizations' operations should have been very different, it was not rare for a US company to operate globally,

making IASC and FASB interests converge towards global accounting standards. This last aspect will be further analyzed in the next paragraphs.

1.1.6. FROM IASC TO IASB

Over time, the number of worldwide business interactions kept growing rapidly, up to a point in which a more systematic, independent, and professional approach to international standard setting was inevitably required. For this reason, in 2001, IASC was reorganized into a new entity called International Financial Accounting Board (IASB). The most relevant changes for this new organization are related to its structure, which is more oriented towards independence and autonomy, and governance: the overall governance structure was provided by the International Financial Reporting Standards (IFRS) Foundation, a not-for-profit entity responsible for the oversight and direction of IASB activities. It was composed by a Monitoring Board, Trustees, and IASB.

Another source of difference between IASC and IASB was the consultative approach of the latter in setting its standards, referring to a higher engagement and proactivity towards global stakeholders, including regulatory authorities.

Also, the standards set by IASB changed their name from International Accounting Standards (IAS) to International Financial Reporting Standards (IFRS), and they started to gain even more worldwide acceptance than IAS.

1.1.7. CONVERGENCE BETWEEN IASB AND FASB

In paragraph 1.1.5 the substantial differences among IASC (now IASB) and FASB were analyzed. Nevertheless, as anticipated, there've been cases in which the interests of the two organizations got to converge to a common point, leading to a collaboration to achieve global acceptation and adoption (or convergence to) of the accounting standards. Such a collaboration took the form of a memorandum of understanding and was called the "Norwalk agreement". It states as follows:

"At their joint meeting in Norwalk, Connecticut, USA on September 18, 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) each acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, both the FASB and IASB pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.

To achieve compatibility, the FASB and IASB (together, the "Boards") agree, as a matter of high priority, to:

a) undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);

b) remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
c) continue progress on the joint projects that they are currently undertaking; and,
d) encourage their respective interpretative bodies to coordinate their activities.
The Boards agree to commit the necessary resources to complete such a major undertaking."[6]

The significance of this agreement is to find in the convergence of the two world's most accepted accounting standard-setting systems. Therefore, the two organizations launched a series of short-term (borrowing costs, government grant, income taxes, etc.) and long-term (financial statement presentation, insurance contracts, intangible assets, etc.) convergence projects. However, since IASB and FASB operated at different scales, under different jurisdictions and through different processes and systems, the collaboration was not immediately effective. In fact, the memorandum of understanding was reviewed, updated, and reissued two times, in 2006 and 2008. In the latest version (2008), the parties set the goal of completing the major joint projects by 2011. Moreover, in 2009, G20 issued a

[6] International Financial Reporting Standards (IFRS) Foundation. *Memorandum of Understanding – "The Norwalk Agreement",* 2002.

statement requiring the convergence of accounting standards by 2011, as well. Even tough, the required deadline was not met: still today, for some projects, convergence was just broadly achieved; for others it was never achieved, basically because the two parties weren't able to find an agreement, and differences remained.

It could be argued that convergence could be a short-term solution, but it's not sustainable in the long run. It should be the initial step towards adoption, but they're not substitute, and the Norwalk agreement and its evolution demonstrated that. To support that thesis, it's useful to cite IFRS Foundation's statement in the report for 2011 Strategy View:

"*As the body tasked with achieving a single set of improved and globally accepted high quality accounting standards, the IFRS Foundation must remain committed to the long-term goal of the global adoption of IFRSs as developed by the IASB, in their entirety and without modification. Convergence may be an appropriate short-term strategy for a particular jurisdiction and may facilitate adoption over a transitional period. Convergence, however, is not a substitute for adoption. Adoption mechanisms may differ among countries and may require an appropriate period of time to implement but, whatever the mechanism, it should enable and require relevant entities to state that their financial statements are in full compliance with IFRSs as issued by the IASB*."[7]

[7] PACTER P. *What have IASB and FASB convergence efforts achieved?* Journal of Accountancy, 2013.

1.2. THE ROLE OF INTANGIBLE ASSETS

Section 1.1 has been useful to define the evolution of the regulatory context over the years, which has reached high levels of complexity nowadays. From now on, a focus will be posed on intangible assets and related features, adding up to the existing complexity.

1.2.1. DEFINITION OF INTANGIBLE ASSETS

To recall the definition given at the beginning of the chapter, according to IAS 38, intangible assets are *identifiable, non-monetary assets without physical substance*. Some common intangible assets for companies are: patents, know-how and trade secrets, trademarks and brands, licenses and similar rights, goodwill and going concern value, group synergies/scale economies, market specific characteristics, assembled workforce, R&D.

1.2.2. MAIN FEATURES

Staying faithful to IAS 38, three main criteria characterize an intangible asset:

- Identifiability: intangible assets are identifiable, meaning separable from the entities that possess them, transferable or exchangeable.

- Control: intangible assets can be controlled by entities, in the sense that organizations have the power to extract the whole economic benefits from such assets and restrict the access of others to those benefits. Having legal rights over an intangible asset means to control it.
- Future economic benefits: economic benefits are associated to the use and exploitation of intangible assets.

In order for an intangible asset to be defined as so, it must comply to the presented definitions, but it also has to meet the recognition criteria: first of all, it must be probable that the future economic benefits generated by the use of the asset will flow to the entity in its possession; secondly, the cost of the asset must be measurable reliably. Those two conditions are necessary for intangibles to be recognized.

1.2.3. A SINGULAR INTANGIBLE ASSET: GOODWILL

In accounting, goodwill refers to the premium price paid by a company to acquire another. In other words, it is the fraction of the total purchase price that exceeds the net value of all the assets possessed by the acquired company. In fact, usually a company is willing to pay more than "market" value for acquiring another because of assets that are not easy to quantify, which can provide value to the acquiring firm. Those assets include customer relationships, reputational capital, brand

names, and human capital. Such resources are not easily measurable in computing the net market value of the target company, but they can still be sources of competitive advantage for the purchasing firm. The singularity of goodwill assets as intangible assets is their unidentifiability: goodwill cannot be physically separated by the entity in its possession, it cannot be sold or transferred individually. Therefore, goodwill is the most common exception to the definition criteria of intangible assets, being an example of unidentifiable intangible resource. Moreover, it is considered as a long-term asset (or non-current), in the sense that its value is not provided and consumed within a single year, but it takes a longer period of time to be entirely exploited.

1.2.4. CLASSIFICATION OF INTANGIBLES

The literature proposes several classifications for intangible assets, based on different criteria. The first, broadest distinction is between identifiable assets, that can be separated from the company which possess them, and unidentifiable assets, which cannot be physically separated from their possessors (goodwill). A second general distinction is based on the origin of the intangible resources: according to this criterion, it’s possible to identify internally generated intangible assets, whose creation entirely takes place within one single company, and externally acquired intangible assets, which are transferred or purchased from other entities.

Nevertheless, a more specific distinction is necessary in order to better fit with the scope of the analysis: the following table (*Tab. 2*) will present a more formal and detailed classification of intangible assets, which divides them in five classes according to their nature and main characteristics.

Tab. 2: Classification of Intangible Assets.

Intangible assets class	Main Examples
Marketing-related	Trademarks, trade names, service marks, internet domain names, non-competition agreements.
Technology-based	Patented technologies, trade secrets, know-how, R&D, computer software and databases, formulas, proprietary technologies, proprietary processes.
Customer-related	Customer lists, production backlog, customer relationships (contractual and non-contractual).
Contract-based	Licensing agreements, royalty agreements, lease agreements, employment contracts, advertising contracts, use rights, servicing contracts.
Artistic-related	Literary works, books, magazines, pictures and photographs, video and audiovisual material, music works.

Sources: MPI, PWC

Marketing-related intangible assets are mainly used in the marketing and promotion of products or services; they usually undergo legal protection, which allows to clearly identify them and so to meet the recognition criteria. For instance, trademarks and trade names are generally registered in governmental agencies' databases (or anyhow protected through other instruments), which makes their recognition and separation from the entity in their possession much easier.

Technology-based intangible assets refer to innovations on existing products or services, but also digital collections of information (such as software and databases). The main example of such assets are patented technologies, which undergo legal protection and therefore meet the recognition criteria. Unpatented technologies, for instance, do not meet the recognition criteria (because they're not legally protected) unless they're sold together with other intangible assets, such as trade names or formulas.

Customer-related intangible assets are those which rely on the whole network of interactions between companies and customers. In fact, they include assets such as customer relationships, both contractual and non-contractual, customer lists, orders backlog. Generally, each interaction that a company has with its customers includes more than one customer-related intangible asset: for instance, a customer contract will surely result in customer relationships.

Contract-based intangible assets are defined as the value of rights and duties deriving from contractual agreements, such as licensing agreements, royalty

agreements, advertising contracts, employment contracts, lease agreements and many others.

Artistic-related intangible assets can be defined as "creative assets", and they include for instance literary works, music works, books, pictures and so on. They're typically protected by copyrights or other legal instruments.

Such a detailed classification allows to have a deeper understanding of the main features that define and differentiate intangible assets. That will be helpful for the continuation of the analysis.

1.2.5. EVALUATION OF INTANGIBLES AND RELATED PROBLEMS

What emerges from the previous paragraphs is that intangible assets can be very difficult to identify and recognize, yet it's even more complex to reliably measure them. In fact, their lack of physical substance and their frequent absence or obscuration from companies' balance sheets raise several challenges in intangibles' evaluation. Such problems gain even deeper importance in today's context, in which business models themselves have taken intangible forms: today's businesses are entirely built upon their intangible assets, several of them do not even possess physical assets. To support this thesis, it's sufficient to think that most managers' priority is to build a strong and trustworthy brand, and this is true for the majority of industries. Therefore, the challenges posed by the evaluation of intangible assets

become a primary concern in today's business environment. In the following table (*Tab. 3*), the main risk areas for the measurement of intangibles have been identified and analyzed in detail.

As stated in the table, all the presented risk areas impact on the evaluation outcome, meaning that they often lead to discrepancies in the evaluation of similar assets across different firms. That results into the development of several different evaluation models, which will be now analyzed in detail.

Tab. 3: Main risk areas for the evaluation of intangible assets.

Risk areas	Descriptions
Lack of market values	Intangible assets usually don't have an active market, meaning that they're not transferred on a consistent basis (number of transactions) over different markets. This implies objective difficulties in determining a fair value for them on the basis of previous or existing market transactions.
Subjectivity	The fact that is hard to determine a priori the value of intangible assets brings high degrees of subjectivity to the evaluation outcome. This could result in very different measures for similar intangible assets, which is in clear contrast with IFRS objectives.
Uncertainty	The value of an intangible asset depends on several exogenous variables, that inevitably affect the evaluation outcome. Some of those variables are technological change, regulatory environment, consumer perceptions (think to brand names), customer relationships, market demand and trends, competitive forces, and many others. Especially in today's complex and continuously evolving business environment, such variables are subject to several and sudden changes, thus reflecting on the evaluation of the related assets.
Complexity of evaluation methods	Intangible assets are characterized by a series of complex features, therefore requiring complex systems and models to evaluate them, which are not of easy understanding and implementation by every company. Moreover, different intangible assets require different evaluation methods, thus a combination of different models is needed. That results in higher degrees of complexity relative to intangibles evaluation.
Lack of standardization	Each intangible asset usually possesses unique features with respect to others. This results in a lack of comparability between assets, even similar ones, generating therefore different evaluation outcomes (recall subjectivity and uncertainty).
Lack of available and reliable data	Since it's difficult to determine a priori intangible assets value, a suitable solution would be to gather and analyze available data. Nevertheless, it's extremely difficult to find them, because publicly available data are often limited, and proprietary data by companies are usually inaccessible. That poses further challenges for the final evaluation.

1.2.6. MAIN EVALUATION MODELS

Over time, different methods have been developed to provide reliable measures of intangible assets. Of course, to determine the optimal method, the nature of the intangible asset and the quality of relative available information play a crucial role. Three main basic models can be distinguished:

- Cost Approach: the value of an intangible asset is determined by the cost needed to replace or recreate the asset. This method is often used for intangible assets whose costs are relatively more measurable, such as patents and software. For instance, to determine the value of a patent, the aspects to consider would be R&D costs, testing costs, costs for obtaining the patent, e.g. the total costs needed to reproduce that patent. The Cost Approach model is particularly useful in cases when there's lack of standardization (comparability) and market values, as described in *Table 2*.
- Market Approach: the value of an intangible asset is determined by considering the market values of similar assets that have been subject to recent business transactions. On the one hand, such a method is extremely straightforward, relies on generally available data and keeps away the subjectivity matter. On the other hand, as argued above, it is often challenging to detect similar transactions of similar intangible assets, and even if they exist, they might not be a sufficiently consistent number. Therefore, the Market Approach tends to be less useful for intangible assets

that possess unique features. Moreover, an important aspect for the success of this method is surely the quantity and quality of publicly available data, whose relative problems have been discussed above.

- Income Approach: the value of an intangible asset is estimated on the basis of its expected future economic benefits or the expected future cash flows that it will generate; that value is then discounted to the present value through the application of a discount rate which includes, for instance, time necessary for the generation of the benefits and level of risk involved. If this method is applied over multiple periods of time, it's called Discounted Cash-Flow Method (DFC). A simplified version of it is the Capitalized Cash-Flow Method (CCF), which by contrast is a single-period evaluation model, used in cases when stability in long-run cash-flows is expected.
  The Income Approach is commonly used for the evaluation of intangible assets such as trademarks and copyrights, but also customer relationships.

The following table (*Tab. 4*) will show in detail which of the presented models generally applies to some the main classes of intangible assets. Each class will be characterized by a primary, secondary, and tertiary approach model.

Tab. 4: Evaluation models usually applied to main classes of intangible assets.

Intangibles' class	Primary approach	Secondary approach	Tertiary approach
Patents	Income	Market	Cost
Technology	Income	Market	Cost
Copyrights	Income	Market	Cost
Assembled workforce	Cost	Income	Market
Internally developed software	Cost	Market	Income
Brand names	Income	Market	Cost
Customer relationship	Income	Cost	Market

Source: AICPA[8]

What emerges is that the primary approach for evaluating intangibles, as evidenced in the table, usually is the Income Approach. Within its framework, other, more complex evaluation methods have been developed, which generally rely on combinations of the Income Approach's and other approaches' assumptions, or slight variations of them. Some examples are the following:

- Relief from Royalty Method (RRM): the value of an intangible asset is determined by the savings in royalty payments that would be hypothetically paid for the use of that asset in the case of licensing. First, the royalty rate for licensing is estimated, then it is applied to the revenue generated by the asset to determine its actual value. RRM is often used for intellectual property assets (patents, trademarks), for which licensing costs could be

[8] PUCA A.; ZYLA M. L. *The Intangible Valuation Renaissance: Five Methods*. CFA Institute, 2019.

relevant. This method rests on the assumptions of both market and income approaches.

- Multiperiod Excess Earnings Method (MPEEM): it is a variation of the DCF method (Income Approach), which isolates the cash-flows associated with a single intangible asset, then discounting them to a present value (just as DCF). In other words, the value is determined by the present value of excess earnings generated by an intangible asset. MPEEM is often used for the evaluation of assets such as software and customer relationships, and it's useful for assets that provide primary value to companies, whose related generated cash-flows can be easily isolated from others.
- Greenfield Method: the value of an intangible asset is determined by the amount of discounted cash flows deriving from a hypothetical start-up business. The underlying assumptions is that the asset in question is the only one possessed by the company at the outset. The hypothetically generated income is discounted to a present value by a risk-adjusted discount rate. Just as MPEEM, also the Greenfield Method is a modified form of DCF method. This model is commonly used to evaluate assets such as franchise agreements and licenses.

1.2.7. IMPLICATIONS OF INTANGIBLE ASSETS FOR ACCOUNTING SYSTEMS AND PRINCIPLES

Historically, intangible assets weren't recorded on firms' balance sheets, or, if they were, their treatment was extremely subjective and, therefore, variable across different companies. Nevertheless, when intangibles started gaining increasing more and more importance to an increasing number of businesses, accounting experts expressed the need for more consistent and transparent reporting for intangible assets. The first step to be mentioned in this direction was the publication by the American Institute of Certified Public Accountants (AICPA) of Accounting Principles Board (APB) Opinion, No. 17, in 1971. That was the first official statement about the accounting treatment for intangible assets: it provided guidance for the evaluation and registration of assets such as trademarks, patents, copyrights, and goodwill. Three years later, in 1974, FASB issued Statement of Financial Accounting Standards (SFAS), No. 2, titled "Accounting for Research and Development Costs". The statement "*establishes standards of financial accounting and reporting for research and development (R&D) costs. This Statement requires that R&D costs be charged to expense when incurred. It also requires a company to disclose in its financial statements the amount of R&D that it charges to expense*."[9]

[9] Financial Accounting Standards Board (FASB). *Summary of Statement No. 2 – Accounting for Research and Development Costs*. 1974.

Another milestone in the recognition and evaluation of intangibles took place in 2001, year in which FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets", which was intended to substitute APB Opinion, No. 17. The statement was aimed at addressing the problem of accounting treatment of those intangible assets acquired individually or within a "package" of other assets (not business combinations), with a special focus on goodwill.

The main difference between APB Opinion, No. 17 and SFAS, No. 142 is the required approach towards goodwill and other intangible assets' treatment after the initial recognition, basically by changing the unit of account for them. Specifically, in APB Opinion, No. 17, goodwill and other assets were considered as "wasting assets", meaning that they had a finite life. According to that, they needed to be amortized over the duration of their useful life for the determination of net income. It also established an arbitrary cap of 40 years to that amortization. On the other hand, SFAS, No. 142 considered the existence of indefinite-lived assets, which shouldn't have to be amortized, but rather tested for impairment on annual basis (at least). Moreover, it established that finite-lived intangible assets should have continued to be amortized over their useful life, but the arbitrary cap of 40 years was removed. The statement also provided guidance about how to measure impairment for such assets. In order to better understand the importance of such statement, it's useful to cite directly FASB's Summary of Statement, No.142:

"*Reasons for Issuing This Statement:*

Analysts and other users of financial statements, as well as company managements, noted that intangible assets are an increasingly important economic resource for many entities and are an increasing proportion of the assets acquired in many transactions. As a result, better information about intangible assets was needed. Financial statement users also indicated that they did not regard goodwill amortization expense as being useful information in analyzing investments."[10]

In the same year, 2001, IASB issued IAS 38, "Intangible Assets", which was already cited and studied in the previous paragraphs. It can be arguably considered as the most relevant guidance on the topic of intangible assets, since it is still today the landmark for the definition, recognition, and evaluation of intangibles.

One more relevant statement about the treatment of intangible assets is IFRS 3, "Business Combinations", first issued by IASB in 2004, then revised and modified in 2008 and 2019 (latest version). The aim of such statement is the following:

"*The objective of this IFRS is to improve the relevance, reliability and comparability of the information that a reporting entity provides in its financial statements about a business combination and its effects*."[11]

[10] Financial Accounting Standards Board (FASB). *Summary of Statement No. 142 – Goodwill and Other Intangible Assets*. 2001.

[11] International Accounting Standards Board (IASB). *IFRS 3 – Business Combinations*. 2019 (*update*).

In specific, the statement provides principles for how the acquirer must recognize and evaluate identifiable assets obtained, liabilities assumed during the combination, and goodwill acquired through it. It also provides guidance on what pieces of information need to be disclosed in the financial statement of the acquirer, in order to allow users to understand and evaluate the nature and effects of the combination. Such statement is extremely important for the recognition and evaluation of a frequently problematic intangible asset, which is goodwill.

2. TRANSFER PRICING AND FISCAL SIGNIFICANCE: BEPS, OECD, AND THE INCLUSIVE FRAMEWORK

The previous chapter was intended to provide a background for the conducted analysis, by defining and investigating the debated topic of intangible assets and the context they integrate in. The intrinsic characteristics of such assets, coupled with the difficulties connected to their recognition and quantification, carry out significant implications and exert a major influence in corporate strategies, especially when considering fiscal aspects. In fact, it's not rare for companies, mainly Multinational Corporations (MNCs), to leverage intangible assets and associated accounting challenges to their advantage, notably when setting transfer prices within different divisions of the same firm. The strategic link between intangible assets and transfer pricing will be presented and deeply analyzed in the present chapter.

2.1. WHAT IS TRANSFER PRICING: INTRODUCTION AND FISCAL BACKGROUND

2.1.1. CONTEXT AND DEFINITION

As argued above, a strong connection has arisen over time between intangible assets and transfer pricing strategies: globalization, technological changes, trade

liberalization, financial integration and other emerging phenomena led to a consistent increase in the volume of international transactions. In that context, many firms, especially MNCs, have decided to allocate their business, or part of it, across different national borders, into different countries. This tendency usually depends on trends of the domestic market which are no longer favorable for some companies, such as market saturation or recession, but also, for instance, unfavorable policies set by domestic governments. In addition to that, internalization processes are often implemented by companies for strategic reasons, which include diversifying risks and increasing returns on investments. In practice, firms tend to separate or divest a portion of their business, which is then allocated into new independent entities in different countries. The shares of the new entities, called subsidiaries, are then distributed among the current shareholders of the main firms, called parent companies; in this way, they become shareholders for both parents and subsidiaries. That process takes the name of spin-off and provides several benefits for firms (spin-off benefits). In fact, parent company and subsidiary are considered as two separate entities, each one independent from the other; this allows the parent firm to split and diversify its risks, so to stabilize its earnings over time, but also to attract new investors from other countries, therefore increasing its returns and overall profits. Those are the main strategic drivers for firms deciding to spin-off their business. Being legally independent entities, parent companies and subsidiaries are involved in contractual transactions for the exchange of goods,

services, and other assets, defined as intercompany transactions. This means that they need to agree upon a price at which to exchange assets, which is called transfer price. To cite OECD Guidelines, which will be later analyzed in detail, "*transfer prices are the prices at which an enterprise transfers physical goods and intangible property or provides services to associated enterprises.*"[12]

Two enterprises are defined associated "*if one of the enterprises participates directly or indirectly in the management, control or capital of the other.*"[13]

2.1.2. FISCAL ASPECTS: CORPORATE TAX RATES AND BUSINESS SIGNIFICANCE

What we know from economic literature is that, generally, every company's main goal is to survive and prosper, which is achieved by maximizing overall profits and minimizing total costs. A relevant portion of those costs, especially for dominant firms such as MNCs, is frequently represented by taxation. The percentage of companies' profits (taxable income) which a company is required to pay in taxes to the government is defined corporate tax rate. The idea is that, since tax revenues obtained by governments are expended to increase social welfare (public services,

[12] *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. 2022 (*update*).
[13] OECD Model Tax Convention. *Art. 9 – Associated Enterprises*. 2017.

infrastructures, and so on), a higher corporate tax rate results into a better social wealth. This means that, from government's perspective, corporate tax rates are crucial policy tools to generate revenue and contribute to a higher welfare. For this reason, in the past, governmental institutions tended to impose extremely high tax rates if compared to the ones in force today: in 1980, the global average corporate tax rate was 40,11%. Nevertheless, from a business point of view, such a tendency has negative implications for companies: in fact, tax rates play a fundamental role in the financial-planning and decision-making processes of corporations, notably affecting cash flows, investment decisions, competitiveness, and profitability. For instance, a company operating in a high tax country may have no incentives to invest in new products or technologies, because potential returns would be burdened by the heavy taxation. Another relevant negative consequence for companies facing high tax rates is related to international competitiveness: MNCs in high tax jurisdictions could find themselves in a position of competitive disadvantage with respect to counterparts in low tax jurisdictions. That would cause several challenges for the formers, such as competing in international markets and attract Foreign Direct Investments (FDI).

For those reasons, after 1980, governments recognized the impact of corporate tax rates on business environment, thus a gradual decreasing trend started. In 2023, the global average corporate tax rate was 23.45% for 181 independent jurisdictions.

2.1.3. DATA ANALYSIS: GLOBAL CORPORATE TAXATION

To support what stated in the previous paragraph, a data set containing corporate tax rates from 1980 to 2023 for more than 250 countries worldwide has been analyzed, in order to understand the main features and trends of corporate tax rates globally. According to that, in the following, two tables will be shown: the first one (*Tab. 5*) contains the ten world's highest taxed countries, whereas the second one (*Tab. 6*) includes the ten world's least taxed jurisdictions. In those tables, also a variation analysis has been performed, with the objective of investigating the evolution of corporate tax rates in those jurisdictions among 1980 and 2023.

N.B. Since the data set in object contained some missing values, the related observations (e.g. countries) have been removed from the analysis, in order to avoid computational inconsistencies and enhance comparability between different countries.

From *Tab. 5*, it's notable that, as of 2023, most of the highest-taxed countries are from South America (Argentina, Colombia, Brazil, Venezuela, Costa Rica, and Honduras). This could be due to the high levels of public debt of those countries, which exert pressure on governments to meet their financial obligations. That could be an incentive for South American governments to impose higher corporate tax rates, in order to collect higher revenues to finance public debt. Also, the political instability which characterizes those country could be a factor that drives up corporate tax rates, as a tool for governments to seek financial stability.

Tab. 5: Ten World's Highest-Taxed Countries, 2023.

COUNTRY	CTR 2023	CTR 1980	CTR 1990	CTR 2000	CTR 2010	Δ 1980-90	Δ 1990-00	Δ 2000-10	Δ 2010-23	Δ 1980-2023
Argentina	35%	33%	20%	35%	35%	-13%	15%	0%	0%	2%
Colombia	35%	40%	30%	35%	33%	-10%	5%	-2%	2%	-5%
Malta	35%	32,50%	35%	35%	35%	3%	0%	0%	0%	3%
Brazil	34%	35%	30%	37%	34%	-5%	7%	-3%	0%	-1%
Venezuela	34%	50%	50%	34%	34%	0%	-16%	0%	0%	-16%
Morocco	32%	48%	40%	35%	30%	-8%	-5%	-5%	2%	-16%
Australia	30%	46%	39%	34%	30%	-7%	-5%	-4%	0%	-16%
Costa Rica	30%	45%	30%	30%	30%	-15%	0%	0%	0%	-15%
Honduras	30%	40%	35%	25%	35%	-5%	-10%	10%	-5%	-10%
India	30%	60%	50%	38,50%	33,99%	-10%	-12%	-5%	-4%	-30%
AVERAGE	**33%**	**43%**	**36%**	**34%**	**33%**	**-7%**	**-2%**	**-1%**	**0%**	**-10%**

Source: Tax Foundation[14]

[14] ENACHE C. *Corporate Tax Rates around the World*. Tax Foundation. 2023.

Tab. 6: Ten World's Least-Taxed Countries, 2023.

COUNTRY	CTR 2023	CTR 1980	CTR 1990	CTR 2000	CTR 2010	Δ 1980-90	Δ 1990-00	Δ 2000-10	Δ 2010-23	Δ 1980-2023
Cayman Islands	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Bermuda	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Bahamas	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Bahrain	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%
Barbados	5,50%	45%	35%	40%	25%	-10%	5%	-15%	-20%	-40%
United Arab Emirates	9%	0%	0%	0%	0%	0%	0%	0%	9%	9%
Paraguay	10%	30%	30%	30%	10%	0%	0%	-20%	0%	-20%
Ireland	12,50%	45%	43%	24%	12,50%	-2%	-19%	-12%	0%	-33%
Cyprus	12,50%	42,50%	42,50%	29%	10%	0%	-14%	-19%	3%	-30%
Oman	15%	50%	50%	30%	12%	0%	-20%	-18%	3%	-35%
AVERAGE	**6%**	**21%**	**20%**	**15%**	**7%**	**-1%**	**-5%**	**-8%**	**-1%**	**-15%**

Source: Tax Foundation[15]

[15] ENACHE C. *Corporate Tax Rates around the World*. Tax Foundation. 2023.

From *Tab. 6*, it emerges that Cayman Islands, Bermuda, the Bahamas, and Bahrain have always been imposing 0% corporate tax rates since 1980, and that never changed over time (unlike, for instance, United Arab Emirates, which always imposed 0% as well, but suddenly increased it to 9% in 2023, probably due to the possibility of introduction of a minimum corporate tax rate, which will be treated later). Those countries are defined as *tax havens*, whose strategic role and significance will be discussed in the following section.

Overall, considering both *Tab. 5* and *6*, the average variation of corporate tax rates between 1980 and 2023 is substantially negative: minus 10 percentage points for the highest-taxed countries, and minus 15 percentage points for the least-taxed jurisdictions. That confirms the negative trend incurred by global corporate tax rates, which was highlighted in the previous paragraph, together with its determinants.

In addition, from the same starting data set, after the elaborations and adjustments pointed out above, a graph has been generated, mapping the global distribution of corporate tax rates in 2023. It is shown in *Fig. 1*.

Fig. 1: Global Distribution of Corporate Tax Rates by Country, 2023.

Source: Tax Foundation[16]*, R Studio*

[16] ENACHE C. *Corporate Tax Rates around the World*. Tax Foundation. 2023.

2.1.4. TAX STRATEGY

The development of a fiscal strategy by Multinational Companies includes two main components:

- Tax Policy: setting a governance framework which provides principles on which fiscal decisions are made and activities are implemented. It's composed by standards and key policies for the management of tax liabilities.
- Tax Strategy: developing a plan based on actual data, which implies tax decisions as a starting point to achieve the final organizational goals.

In order to develop a tax strategy which is in line with the overall corporate strategy, organizations must first of all review their existing tax strategies, and compare them to corporate values and policies, keeping sight on today's business priorities. If discrepancies emerge, firms must be able to close them out, by redefining both strategic and policy approaches. In doing this, they must take into consideration the strong financial and reputational impact that such changes could have on stakeholders (investors, customers, and so on).

Also, the effective communication of the tax strategy to all the involved actors is a crucial determinant of strategic success. All stakeholders must be aware of the company's tax strategy, its key elements, features, and the values on which it is founded.

A last relevant aspect in defining a successful tax strategy is to give it a long-term orientation, ensuring that all the relevant decisions and actions of the company tend to align with that strategy in the long run. This aspect also requires a periodical update of stakeholders about how the activities are being carried out over time.

2.2. BASE EROSION AND PROFIT SHIFTING (BEPS)

2.2.1. HOW COMPANIES AVOID PAYING TAXES

As seen in the last paragraph, corporate tax rates, despite having decreased during the last decades, still absorb a substantial portion of companies' profits: the global average in 2023 was 23.45%, which is almost one quarter of the total corporate profits. That induces firms to develop effective tax strategies, whose main objectives are therefore to minimize overall tax burdens, enhance profitability, obtain competitive advantages, diversify, and manage risks, and create value for shareholders in the form of increasing after-tax returns.

Two of the most diffused methods, notably used by multinational companies, to reduce corporate tax liabilities are base erosion and profit shifting. In specific, base erosion occurs when taxpayers use deductible payments, such as royalties or interests, to reduce the amount of their profits in the jurisdiction where they're earned. Profit shifting, instead, occurs when MNCs move their profits from one

jurisdiction to another through intercompany (or intra-group) transactions (parent-subsidiary mechanism as presented above). The two methods are frequently combined by companies, for this reason they fall under the common label of BEPS (Base Erosion and Profit Shifting). The basic idea is that companies prefer to locate their profits in low-tax jurisdictions rather than in high-tax countries, in order to reduce their taxable income where tax burden is heavy. To do that, they exploit corporate tax rates gaps between different countries to their advantage, in a way that their profits are ideally not recognized by any country: the so-called "Stateless Income". To cite OECD:

"*Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax*."[17]

Those techniques rely on the fact that tax systems are nation-based, but that raises questions about their fairness and equity.

2.2.2. THE ROLE OF TRANSFER PRICING: STRATEGIC USE

In order to shift profits to low tax jurisdiction, and therefore reduce tax liabilities, an important lever is transfer pricing. In fact, multinational companies often have

[17] OECD. *Inclusive Framework on Base Erosion and Profit Shifting*. 2016.

several subsidiaries located in different countries, with which they involve in transactions for exchanging goods, services, and intellectual capital. By manipulating to their advantage the prices charged for those transactions, companies are able to artificially shift their profits to low tax countries. In fact, transfer prices allow multinational companies to allocate their earnings among different subsidiaries; if it is set at a strategic level, it allows the same companies to minimize profits in high-tax jurisdictions by inflating them in low-tax jurisdictions. In principle, the setting of transfer price should follow the *Arm's Length Principle*, agreed and adopted by OECD members as an objective guideline for regulating that mechanism: the financial conditions of a transaction between two associated enterprises should be set according to the financial conditions of comparable market transactions among unrelated enterprises. In other words, a transaction occurring between two related business units should be financially treated in the exact same way as a sale to an eternal customer. Nevertheless, since those exchanges take place within a unique organization, the company has considerable discretion in setting transfer prices. Moreover, since both subsidiaries, are evaluated on the basis of their own division profits, and not on the company's overall profit, their objective is to set an optimal transfer price such that, acting in each own self-interest, drives decisions in the company's best interests. This means that each division wants to maximize its contribution margin, defined as the incremental profits generated by each subsidiary for each unit sold, after deducting the portion of firm's variable

costs. Therefore, each division's managers are completely indifferent about transfer prices unless they affect their own contribution margin. In specific, one possible approach in determining the optimal transfer price implies that:

$$Transfer\ Price\ (TP) = \ Outlay\ Cost + Opportunity\ Cost$$
$$at\ the\ Moment\ of\ the\ Transfer$$

Where Outlay Cost is the cost incurred to acquire a given asset, whereas Opportunity Cost is the cost deriving from a forgone profit arising from a missed opportunity, meaning the reduced profit coming from a non-optimal employment of resources, non-optimal strategy, and so on.

Such strategic framework is notably relevant for international transfer pricing, since multinational firms have developed an ability to exploit discrepancies among national tax systems, and so to increase profits where taxation is low, instead decreasing them where tax burden is heavy. In the following paragraph, a practical example will be shown to facilitate the understanding of that strategic mechanism.

2.2.3. A PRACTICAL EXAMPLE: CARSPACEX

CarSpaceX is an automobile manufacturer, parent company for two subsidiaries, one of the two, Subsidiary A, produces software for the car, and it's located in a

high-tax jurisdiction, say Country A; the other one, Subsidiary B, manufactures the final car, and it's located in a low-tax jurisdiction, say Country B. Since software is necessary for the assembling of the final car, Subsidiary B needs to purchase it from Subsidiary A: the price charged for that kind of transactions represents transfer price. According to the "Arm's Length Principle" as described above, Subsidiary A should charge a price which is equal to the price charged for comparable transactions among unrelated entities, which is the market price for that specific software. Assume that, instead of doing so, Subsidiary A charges a price to Subsidiary B which is lower than the actual market price. In this way, Subsidiary A collects lower revenues, that is lower profits, than the ones it would get for setting transfer price equal to market price. On the other hand, Subsidiary B, which purchases software from Subsidiary A, incurs lower costs of goods sold (COGS), thus increasing its profits. Please notice that the amount of loss revenues for Subsidiary A is exactly equal to the amount of cost savings by Subsidiary B (compensation), therefore no financial impact on the overall company arises. From a fiscal point of view, since Country A has a high corporate tax rate, making Subsidiary A less profitable means to reduce company's taxable income in that country, and so to reduce the overall amount of company's tax liabilities. At the same time, since Country B is a low-tax country, boosting Subsidiary B profits (through lower COGS) allows CarSpaceX to have a higher portion of profits taxed in a low tax jurisdiction. In short, what CarSpaceX is doing here is artificially

shifting profits from Country A, the high-tax country, to Country B, the low-tax country. Setting a transfer price which is lower than market value, and so making Subsidiary A less profitable and Subsidiary B more profitable, enables the company to save a significant amount of fiscal expenses.

2.2.4. METHODS FOR DETERMINING ARM'S LENGTH PRICE

Taking a step back, it's useful to mention the possible methods used to derivate the optimal transfer price for transactions among different divisions of the same firm. First of all, there are three main policies in the approach to the computation of optimal transfer price:

- Price-based policy: transfer price is set at market price levels, or at a slightly discounted market price.
- Cost-based policy: transfer price is equal to the sum of outlay cost and opportunity cost at the moment of the transfer.
- Negotiation policy: transfer price is negotiated among the buying and selling divisions.

Within the presented approaches, several are the different specific methods that can be used to determine arm's length transfer price. Some of the most common methods are listed below:

- Comparable Uncontrolled Price (CUP) Method: this method compares the price charged for the transfer of goods and services in a controlled transaction to the price charged for a comparable transfer in a comparable uncontrolled transaction. A controlled transaction is defined as a transaction directly occurring between two divisions of the same firm, whereas uncontrolled transactions are intended as those occurring between either parent company and unrelated parties, subsidiaries and unrelated parties (internal comparable transactions), or transactions among two unrelated parties (external comparable transactions). According to CUP method, those transactions should be compared to determine arm's length price. The main comparability drivers are characteristics of the goods or services being transferred, contractual terms, economic circumstances, and related strategies. CUP method can be extremely useful in the determination of optimal transfer price for commodity products, and in general it provides a more direct measure of arm's length price with respect to other methods; nevertheless, it is limited by the fact that, usually, it is extremely difficult to find comparable uncontrolled transactions, notably when considering services and intellectual property.
- Resale Price Method (RPM): arm's length transfer price is indirectly computed by comparing the gross margins obtained in transactions between related and unrelated parties. In specific, this method compares the price

that a related sales company charges to unrelated entities, which is the resale price, to determine an arm's length gross margin. That margin is then deducted from the resale price in order to derive optimal transfer price. The following picture (*Fig. 2*) will clarify RPM mechanism.

Fig. 2: Resale Price Method (RPM).

Given price	=	US$100
Resale price margin (25%)	=	US$ 25
Arm's length price	=	US$ 75

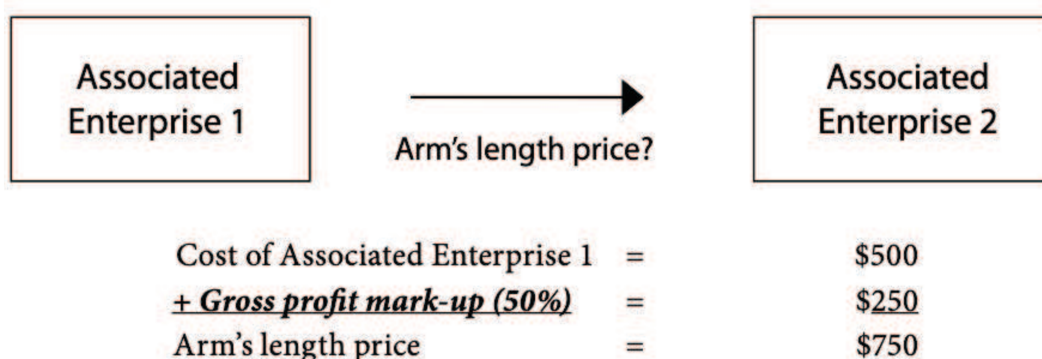
Source: United Nations[18]

RPM thus indirectly determines arm's length prices. Accounting principles are of fundamental importance for the comparability under RPM. In fact, if accounting principles and practices differ among the controlled and uncontrolled transactions, gross margins will not be comparable. For this reason, accounting inconsistencies are the main causes of failure of RPM.

[18] United Nations. *Practical Manual on Transfer Pricing for Developing Countries*. 2013.

- Cost-Plus Method: Cost-Plus Pricing involves setting a price by summing a fixed percentage (markup) to the cost of production of a good or service. This method compares the gross-profit markup on costs sustained by a manufacturer or service provider in controlled transactions to the gross-profit markup obtained by comparable companies in uncontrolled transactions. Arm's length price is equal to the controlled party's cost of production plus an appropriate gross-profit markup, which is defined as the ratio between gross profits and cost of goods sold (COGS). The following image (*Fig. 3*) clarifies the framework.

Fig. 3: Cost-Plus Method.



Source: United Nations[19]

[19] United Nations. *Practical Manual on Transfer Pricing for Developing Countries*. 2013.

The main limitation to the application of Cost-Plus Method is related to the determination of costs, which is often complex, since authorities need to understand which costs to include in the computation and what costs to exclude from it, but also because the link between costs and market prices could be weak. Also, the allocation of those costs can increase the existing complexity. As in the case of RPM, also Cost Plus Method strongly relies on accounting principles: if inconsistencies in regulation between controlled and uncontrolled transactions exist, challenges arise for tax authorities. This method provides an indirect measure for TP as well.

2.2.5. THE ROLE OF TAX HAVENS

The presented BEPS techniques require the presence of low-tax jurisdictions to which multinational companies can shift their profits in order to minimize tax liabilities. That implies pro-activity also from the side of national governments. In fact, there are some countries around the world which offer favorable tax regulations, meaning extremely low or zero tax rates, to individuals and businesses; those countries are called *tax havens.* It is thanks to their existence that multinational companies are able to save billions of dollars in tax liabilities. On the other hand, doubts may arise about the concrete benefits that those countries get from such a strategy: first of all, by attracting investments from foreign

multinational companies, tax haven countries obtain resources that boost their economic growth and, therefore, labor creation. Moreover, through the huge capital flows toward their banks and financial systems, they're able to build up extremely strong and structured financial sectors (think, for instance, to Switzerland and Luxembourg). Furthermore, tax haven countries usually impose high registration fees to companies and individuals willing to establish there; therefore, even if they obtain little revenue from taxation, that is more than compensated by the collection of those fees.

2.2.6. CHALLENGES POSED BY TAX HAVENS: THE EU BLACKLIST

In 1998, OECD defined tax havens those countries which responded to four main characteristics:

- No, or nominal, tax on relevant income
- No substantial activities
- No compliance with international norms
- Lack of effective information exchange
- Lack of transparency

The last two aspects are the main reason why it is extremely hard for tax authorities to deal with tax havens. In fact, those countries are often characterized by financial

secrecy: their financial institutions are not held to disclose information of their clients to foreign tax authorities. That imposes difficulties in tracking and taxing profits generated in, or shifted to, tax havens. For this reason, to protect against tax havens and enhance fair global taxation, European Union drew up a blacklist, under the name of *EU list of non-cooperative jurisdictions*, containing all the countries which have failed or refused to comply with EU good tax governance principles. It was updated in October 2023, and now includes 16 countries: American Samoa, Anguilla, Antigua and Barbuda, Bahamas, Belize, Fiji, Guam, Palau, Panama, Russia, Samoa, Seychelles, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands, Vanuatu.[20] The purpose of that list is not to threaten or put shame on those countries, but rather to encourage a positive change of their fiscal behavior and compliance with international rules. Moreover, another list has been drawn up, containing all those countries which aren't aligned yet with international tax standards, but show their commitment by implementing changes and reforms in their fiscal systems (so-called grey list). At the moment, those countries are: Albania, Armenia, Aruba, Botswana, British Virgin Islands, Costa Rica, Curacao, Dominica, Eswatini, Hong Kong, Israel, Malaysia, Turkey, Vietnam.[21] When a certain country completely fulfills its commitments toward cooperation with EU international tax standards, its name is removed from the list.

[20] ECOFIN Council of European Union. *Conclusions – Annex I*. 2023 (*update*).
[21] ECOFIN Council of European Union. *Conclusions – Annex II*. 2023 (*update*).

2.2.7. IS BEPS LEGAL? IMPLICATIONS AND SOCIAL COSTS

The last provided definition of BEPS from OECD states that it is used to avoid paying taxes. It's particularly relevant to highlight this last aspect in order to introduce the difference between tax avoidance and tax evasion. According to International Revenue Service (IRS), the governmental agency in charge for the collection of federal taxes within the U.S. fiscal system, tax evasion is defined as "*the failure to pay or a deliberate underpayment of taxes*"; whereas tax avoidance is described as "*an action taken to lessen tax liability and maximize after-tax income*"[22]. The difference is in the fact that tax evasion is openly illegal, since it relies on techniques such as under-reporting or not reporting income and falsifying fiscal deductions to reduce tax liabilities. On the other hand, tax avoidance exploits legal methods to reduce the tax burden owed by an individual or a company. In practice, it consists in trying to get as more deductions and credits as possible, through legal instruments. In fact, it is generally allowed by law to individuals and firms to organize their financial structure in a way that optimizes their tax position, by enjoying tax deductions and exemptions.

Thus, if tax avoidance is legal by definition, it's interesting to investigate the other implications that make it such a debated and controversial theme. OECD estimates that governments are experimenting between 100 and 240 billion U.S.$ of revenue

[22] *International Revenue Service* (IRS).

losses per year because of tax avoidance, which is roughly equal to 4-10% of global corporate tax revenues. This means that tax avoidance implies huge social costs: first of all, the reduction of tax revenues collected by national governments results in a reduced expenditure for public services such as infrastructures, education, healthcare, and social welfare programs, also hurting investments, growth, and employment. Secondly, tax avoidance sharpens economic inequality, in the sense that it provides a disproportionate competitive advantage to wealthy multinational firms by allowing them to minimize their tax liabilities, whereas huge tax burdens hang over small firms, which don't have the possibility and resources to exploit those methods. Moreover, the tendency by MNCs to avoid taxation has a strong impact on public opinion: when taxpayers see multinational companies legally avoiding taxes, their will to comply is undermined. This is true also from an individual perspective: if individuals perceive that such large companies are paying far less than their real tax liabilities, they will lose their belief in tax systems, having an incentive to not align with them. In this way, fairness and integrity of the system become compromised.

2.2.8. TAX AVOIDANCE ATTITUDE BY INDIVIDUALS AND COMPANIES

In the previous paragraphs, BEPS techniques and their fiscal and social implications were analyzed. Nevertheless, it could be interesting to study which are the causes

that incentivize people (and, therefore, organizations) to avoid paying taxes. The first answer to that is provided by standard economic theory: individuals (and companies) take their decisions with the ultimate goal of maximizing their utility (that is, profits for firms). It comes by itself that, in such a logic, people avoid paying taxes in order to minimize their fiscal costs, and therefore to maximize their post-tax profits. Nevertheless, another possible answer is provided by behavioral economics, through the introduction of the concept of *tax morale*, generally defined as "*the intrinsic motivation to pay taxes.*"[23] That is an extremely relevant notion, since every tax system in the world heavily relies on voluntary compliance by taxpayers. The main determinants of *tax morale* are socio-demographic conditions and, above all, confidence and trust towards institutional frameworks. Therefore, tax administrations should try their best in increasing tax morale worldwide by building and operating trustworthy institutions, in order to reduce social losses due to global tax avoidance and increase their fiscal income.

[23] OECD. *Tax Morale: What Drives People and Businesses to Pay Tax?* 2019.

2.3. LIMITATIONS TO TAX AVOIDANCE: OECD GUIDELINES AND INCLUSIVE FRAMEWORK

As argued in the latest paragraph, even if legal, tax avoidance has several implications on tax systems' fairness and equity, other than producing huge social costs in terms of reduced public investments. Therefore, trying to limit tax avoidance has become over time a primary concern for regulators. In the present section, all the protective actions taken by international institutions against tax avoidance will be presented in detail.

2.3.1. OECD: BIRTH AND PURPOSES

After World War II, the United States issued the Marshall plan to helps the post-war economic recovery of Europe. In order to effectively manage and administer the program, in 1948, the Organization for European Economic Cooperation (OEEC) was created. Initially, as said, the purpose of the organization was to manage the aids which Marshall plan was providing to Europe. Nevertheless, some years later, OEEC broadened its vision, moving its focus to ensuring economic cooperation and development between member countries: in 1960-61, after a convention in Paris, OEEC officially became Organization for Economic Cooperation and Development (OECD). The difference was not only in the broader

focus, but also in membership: OECD included countries from all the world, not just from Europe.

To cite OECD web page:

"*The Organization for Economic Co-operation and Development (OECD) is an international organization that works to build better policies for better lives. Our goal is to shape policies that foster prosperity, equality, opportunity, and well-being for all.*"[24]

Therefore, OECD is founded on the cooperation among States, institutions, and organizations all around the world. At the moment, it is composed by 38 member countries, which will be listed in the following table (*Tab. 7*) together with the respective year of accession.

[24] OECD. *Who we are*. www.oecd.org

Tab. 7: OECD Member Countries and Year of Accession. [Source: OECD]

Country	Year of Accession
Australia	1971
Austria	1961
Belgium	1961
Canada	1961
Chile	2010
Colombia	2020
Costa Rica	2021
Czechia	1995
Denmark	1961
Estonia	2010
Finland	1969
France	1961
Germany	1961
Greece	1961
Hungary	1996
Iceland	1961
Ireland	1961
Israel	2010
Italy	1962
Japan	1964
Korea	1996
Latvia	2016
Lithuania	2018
Luxembourg	1961
Mexico	1994
Netherlands	1961
New Zealand	1973
Norway	1961
Poland	1996
Portugal	1961
Slovak Republic	2000
Slovenia	2010
Spain	1961
Sweden	1961
Switzerland	1961
Turkey	1961
United Kingdom	1961
United States	1961

2.3.2. OECD STRUCTURE AND FRAMEWORK

OECD structure can be broken down into three main components, each of which is in charge with a different role. The Council represents the decision-making body, which is responsible for providing oversight and strategic direction to the organization. It is composed by representatives of member countries and chaired by the Secretary-General. Meetings occur on a regular basis to discuss the work of the organization and take or change relevant decisions, which are taken by consensus. Once a year, the Council meets for the Ministerial Council Meeting, in which leaders of government, trade, and foreign ministers from member countries are brought together. The aim if that meeting is to monitor the work, set new priorities, and discuss the global economic and trade contexts. Focusing then on execution, OECD works through more than 300 Committees, experts and working groups, which are in charge for discussion and review. In practice, they propose solutions to member countries, assess data, analyze successes and failures, and review policy implementation and impact. Committees' participants come from both member and partner countries to represent state, business, and civil bodies.

Nevertheless, the real work for OECD is provided by the Secretariat. It is composed by directorates and divisions which work together with member countries' policy makers. In this way, they're able to develop empirical evidence useful to guide Committees in policy-making activities, following Council mandates. Secretariat composition is extremely varied: it includes economists, scientists, lawyers,

political analysts, digital experts, statisticians, and many more. They all report to the Secretary-General.

In detail, OECD framework can be expressed by three main activities:

1. *Inform*: the first key activity performed by OECD is to provide knowledge which can be useful for its stakeholders (member, partners). That knowledge is spread through data analysis and reporting, policy briefs, articles, digital contents, and international debates. The objective is to scan and foresee environmental, economic, and social changes, in order to enable member countries' adaptation, and to foster international cooperation as the main tool to improve performance outcomes. To perform this informational task, OECD needs to engage in proactive relationships with its stakeholders, which mainly are governments (in specific, the relationships with G20 and G7 will be analyzed later), parliaments (so-called OECD Global Parliamentary Network), and civil society (for instance, Business and Industry Advisory Committee (BIAC) and Trade Union Advisory Committee (TUA)).
2. *Influence*: through spreading knowledge, OECD wants to convey members and partners to the exploration and implementation of innovative ideas and optimal practices. For this reason, committees, through their work, are called to share insights and inspire. Such an approach is embodied by OECD conferences and seminars, which are open to a huge number of participants

(for instance, OECD Forum, which is the largest annual event, welcomes more than 3500 participants every year), every one of which is required to bring in its unique perspectives and thoughts. OECD influence is exerted by making those perspectives convene, combining them in a suitable way to drive changes.

3. *Set Standards*: the outcome of OECD work is the issuance of standards and codes in collaboration with member countries. The nature of those standards varies: some of them are legally-binding (for instance, the Anti-Bribery Convention, issued in 1997), others are general recommendations without legal power, useful to guide policy makers towards best practice. The objective is to flatten differences in the global environment, and to deepen international cooperation by encouraging all countries to address challenges and improve their performance. To date, OECD has issued more than 450 standards, in the form of conventions, recommendations, guidelines and declarations.

2.3.3. OECD/G20 INCLUSIVE FRAMEWORK ON BEPS

As argued above, Base Erosion and Profit Shifting threaten the equity and fairness of the global business environment. To tackle that threat, OECD engaged in a collaboration with *Group of Twenty* (G20), the international forum which brings

together political leaders, financial ministries, and central banks governors from world's major economies. It includes 19 countries, which are Argentina, Australia, Brazil, Canada, China, France, Germany, Japan, India, Indonesia, Italy, Mexico, Russia, South Africa, Saudi Arabia, South Korea, Turkey, the United Kingdom, and the United States, and two regional bodies: the European Union and the African Union, which became permanent member in 2023. Moreover, Spain is invited as a permanent guest. Parallelly to OECD, G20 works towards international economic cooperation among its members, by addressing global challenges and development investments, and by promoting diplomatic dialogue and collaboration among member countries. Its final goal is to reach global economic stability.

In 2013, OECD and G20 cooperation started, under the label of *OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS)*. It brought together over 140 countries and jurisdictions worldwide, which were required to cooperate for the implementation of the *BEPS Package*, a set of 15 Actions, intended as domestic and international tools, provided to governments and other institutions, to be implemented in order to tackle tax avoidance. The scope is to establish a modern international tax framework, which ensures that profits are taxed in the place where they're earned, or in the place where value is created; but also, to provide higher degrees of certainty, by reducing international discrepancies over the application of international tax norms.

2.3.4. THE 15 ACTIONS AND TWO-PILLAR SOLUTION

BEPS Package consists in 15 Actions, which provide domestic and international norms and instruments useful to address tax avoidance. They will be illustrated in *Fig. 4*.

In addition to that, in October 2021, members of the *OECD/G20 Inclusive Framework on BEPS* agreed to the *Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy*, a comprehensive framework adopted to ensure that Multinational Enterprises (MNEs) pay their fair amount of taxes, and that international tax norms keep pace with the evolving economic environment. *Pillar One* is aimed at ensuring a fairer distribution of profits and taxing rights among countries for the largest MNEs, whereas *Pillar Two* is intended to put a floor to the countries competition for offering advantageous tax rates, through the establishment of a minimum corporate tax rate of 15%.

Fig. 4 and *Fig. 5* illustrate respectively the 15 Actions in detail and the key elements of the *Two-Pillar Solution*.

Fig. 4: The 15 Actions

Overview – BEPS Actions by theme

Coherence	Substance	Transparency	Analysis
Action 2 Neutralising the Effects of Hybrid Mismatch Arrangements	**Action 6** Preventing the Granting of Treaty Benefits in Inappropriate Circumstances	**Action 11** Measuring and Monitoring BEPS	**Action 1** Addressing the Tax Challenges of the Digital Economy
Action 3 Designing Effective Controlled Foreign Company (CFC) Rules	**Action 7** Preventing the Artificial Avoidance of Permanent Establishment Status	**Action 12** Mandatory Disclosure Rules	**Action 15** Developing a Multilateral Instrument to Modify Bilateral Tax Treaties
Action 4 Limiting Base Erosion Involving Interest Deductions and Other Financial Payments	**Actions 8 – 10** Aligning Transfer Pricing Outcomes with Value Creation: Intangibles Risks & Capital High-Risk Transactions	**Action 13** Transfer Pricing Documentation and Country-by-Country Reporting	
Action 5 Countering Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance		**Action 14** Making Dispute Resolution Mechanisms More Effective	

Fig. 5: Key Elements of the Two-Pillar Solution.

Pillar One	Pillar Two
Taxing rights over 25% of the residual profit of the largest and most profitable MNEs would be re-allocated to the jurisdictions where the customers and users of those MNEs are located	GloBE rules provide a global minimum tax of 15% on all MNEs with annual revenue over 750 million euros
Tax certainty through mandatory and binding dispute resolution, with an elective regime to accommodate certain low-capacity countries	Requirement for all jurisdictions that apply a nominal corporate income tax rate below 9% to interest, royalties and a defined set of other payments to implement the "Subject to Tax Rule" into their bilateral treaties with developing Inclusive Framework members when requested to, so that their tax treaties cannot be abused.
Removal and standstill of Digital Services Taxes and other relevant, similar measures	Carve-out to accommodate tax incentives for substantial business activities
The establishment of a simplified and streamlined approach to the application of the arm's length principle in specific circumstances, with a particular focus on the needs of low capacity countries.	

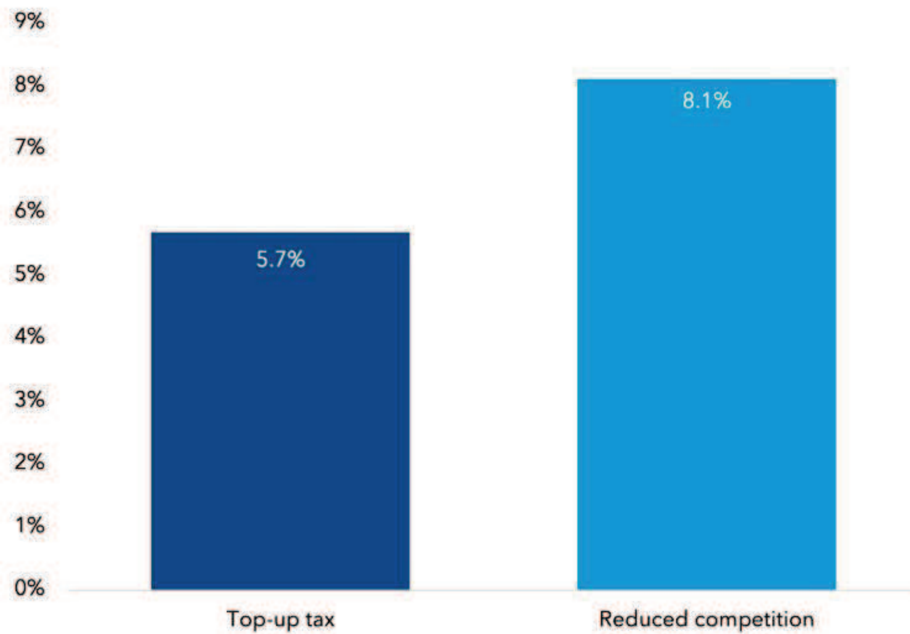
Source: OECD[25]

[25] OECD/G20 Base Erosion and Profit Shifting Project. *Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy*. 2021.

By effectively implementing those norms, OECD/G20 expect that, under Pillar One, taxing rights on more than 125 billion $ of profits will be re-allocated to market jurisdictions; but also, that, under Pillar Two, the minimum corporate tax rate will generate 150 billion $ in worldwide tax revenues. However, the precise impact on tax revenues will depend on the extent of the implementation, the nature and scale of MNEs' and governments' reactions, and future economic developments. Moreover, the Two-Pillar Solution is also expected to provide benefits from an investment perspective, intended as a more favorable environment for investments and growth.

Notice that the absence of that agreement would result in the implementation uncoordinated and unilateral tax measures, which in turn would lead to damaging tax and trade disputes, undermining tax certainty and generating additional compliance and administration costs. The expected impact of that scenario is a reduction of global GDP by more than 1%. The following graph (*Fig. 6*) provides data about the specific impact of the global minimum corporate tax rate proposed in Pillar Two on global tax revenues.

Fig. 6: Minimum corporate tax effect on global tax revenues.



3. TRANSFER PRICING IMPLICATIONS BY INTANGIBLE ASSETS

After having discussed the peculiarities of intangible assets and their increasing significance to business, the focus has been shifted to analyzing transfer pricing and its strategic dimension, through the investigation of tax avoidance, with specific regard to BEPS techniques, their fiscal and social implications, and the corrective actions taken by regulators. The present chapter is intended to provide a connection among the topics presented in Chapters 1 and 2, with the idea of investigating how Multinational Enterprises exploit the controversial features of intangible assets to strategically set transfer prices among their own divisions for BEPS purposes.

3.1. INTANGIBLE ASSETS: STRATEGIC SIGNIFICANCE

3.1.1. UNLOCKING STRATEGIC POTENTIAL: RELEVANT FEATURES

As argued in Chapter 1, intangible assets possess unique features and dimensions which can create several regulatory gaps. That induces MNEs to make use of intangibles to exploit those gaps for tax avoidance purposes. By setting favorable transfer prices for transactions among their divisions, MNEs are able to assign ownership of valuable intangible assets, and so to shift profits, to related entities located in low-tax jurisdictions.

In specific, some of the main characteristics of intangibles which are exploited by firms for tax avoidance purposes are:

- Mobility: intangible assets are highly mobile, meaning that they can be effortlessly transferred from one division to another without physically relocating them. This aspect allows firms to easily move intangibles ownership to those jurisdictions where tax rates are favorable for them.
- Evaluation complexity: as stated in *paragraph 1.2.5*, and specifically in *Tab. 1.3*, the evaluation of intangible assets poses several challenges, as it implies high degrees of subjectivity, uncertainty, complexity of methods, and so on. This is another aspect that facilitates the manipulation of transfer prices and, therefore, the employment of intangibles for BEPS purposes.
- Indefinite useful life: the fact that usually intangible assets are indefinite-lived and their eventual amortization over extended periods of time allows MNEs to spread potential tax benefits arising from strategic transfer pricing for intangibles over several years.
- Global diffusion and value creation: nowadays intangible assets have become the main driving force for competitive advantage, since they contribute to the creation of a significant portion of values for MNEs (think, for instance, to the importance of a strong brand name today). For this reason, they've become increasingly diffused globally. That allows MNEs

to develop effective strategies for the transfer of intangible assets among different jurisdictions, and to justify them.

In the following paragraph, an example will be presented to clarify how MNEs leverage intangible assets in order to reduce their overall tax liabilities.

3.1.2. A PRACTICAL EXAMPLE: TECHPLANET INC.

Assume that TechPlanet Inc. is a multinational technology company which has several subsidiaries located in different countries. Specifically, it has a R&D subsidiary in Country A, which is a high-tax jurisdiction, and two local sales centers in Country B and Country C, both under low-tax regimes. Being TechPlanet Inc. a technology company, it will likely have a significant part of its value generated by intangible assets, such as patents and software rights, which are fundamental to its international strategy and operations.

In order to minimize tax burden, TechPlanet Inc. could, for instance, set up a new subsidiary in a country with favorable tax rates on Intellectual Property (IP), say Country D, then transferring the ownership of valuable intangible assets to the new subsidiary through licensing, meaning contracts through which a company (licensor) confers to another (licensee) the rights for using its patented technologies, brand names, or know-how. By centralizing the

ownership of those valuable assets in a low-tax jurisdiction, TechPlanet Inc. is able to minimize its IP-related tax liabilities by shifting the profits related to those assets to a low-tax country. Suppose now that the new IP subsidiary in Country D engages in intercompany transactions with the R&D subsidiary in Country A, the high-tax jurisdictions. Those transactions involve licensing agreements for the use by the R&D subsidiary (Country A) of the valuable intangible assets which are now owned by the IP subsidiary in Country D. In that scenario, TechPlanet Inc. could apply strategic transfer pricing by setting royalty payments for those licensing agreements above current market values. In this way, the R&D subsidiary in the high-tax jurisdiction would face higher licensing costs, allowing the company to reduce profits in the high-tax country (Country A). In parallel, the IP holding subsidiary in the low-tax jurisdiction would collect higher licensing revenues, thus higher profits for the firm under the low-tax regime. By reallocating its IP-related profits, arising from the ownership and use of valuable intangible assets, from a high-tax jurisdiction (Country A) and a low-tax jurisdiction (Country D), TechPlanet Inc. is able to minimize its overall tax liabilities.

The presented case is a general example of one of the many possible approaches to tax avoidance by MNEs. Nevertheless, multinational companies have developed over time far more complex schemes, involving many different

companies located in many different jurisdictions (see *paragraph 2.2.5. The role of tax havens*).

3.1.3. TAXATION SYSTEMS AND MAIN CHANNELS OF GLOBAL TAX AVOIDANCE

Before going deeply in the analysis of the main tools used by MNEs to avoid taxation, it's necessary to clarify a broad distinction with regard to the different kinds of taxes that different jurisdictions can impose to companies. In fact, it's possible to distinguish among residence-based taxation and source-based taxation. The two will be analyzed in the following:

- Residence-based taxation: residence-based systems are those in which companies are taxed on the basis of their residence. According to those systems, company are not taxed in the place where their income is generated, but in the jurisdiction where they have their tax residence. That means that all the profits earned both domestically and internationally are taxed under the residence country. Each country issues its own requisites for being considered tax resident in that specific jurisdiction: in Italy, for instance, according to OECD an enterprise is considered tax resident "*if at least one of the following conditions are met for a period of time that is greater than half of the tax period:*

1. *Place of incorporation.*
2. *Place of administration of the entity.*
3. *Place where the main and substantial activity is carried on*."[26]

- Source-based taxation: in source-based jurisdictions companies are taxed on the basis of the source of their income, and not on their residency conditions. In other words, profits earned in a given country are taxed under the jurisdiction of that country, regardless of where the enterprise earning them is tax resident.

Generally, most countries combine both residence-based and source-based systems within their jurisdictions, but there are also countries that only adopt source-based taxation. It is interesting to notice that tax havens, such as Cayman Islands, which do not impose taxes on income (see *Tab. 6*), do not even define in their normative codes the concept of tax residence. For this reason, companies incorporated in such countries are considered without tax residence. In countries where the two kinds of systems are combined, it's not rare to find conflicts between them, since double taxation risk arises. For this reason, regulators gave precedence to source taxation over residence taxation: in any bilateral tax agreement, the tax right is allocated to the source country.

[26] OECD. Automatic Exchange of Information (AEOI) Portal. *Tax Residency – Italy* - *Section II*.

Nevertheless, tax avoidance by multinational firms is implemented both towards source systems and residence systems, requiring different channels according to the features of taxation systems that they want to avoid. In the following table (*Tab. 8*), some of the main channels for tax avoidance by MNEs will be presented, distinguishing between residence systems and source systems channels.

Tab. 8: Main Tax Avoidance Channels divided for each taxation system.

TAX SYSTEM	TAX AVOIDANCE CHANNELS	DESCRIPTION
Source-based	Transfer mispricing	Artificially setting favorable transfer prices for transactions among related parties to shift profits from high-tax to low-tax jurisdictions.
	Statregic location of IP	R&D activities are performed in one country, but the ownership of the resulting assets is then transferred to subsidiaries in low tax jurisdictions.
	International debt shifting	Lending capitals from low-tax countries to subsidiaries in high-tax countries or locating external borrowed capitals to high-tax jurisdictions, reducing the group's tax bill without changing overall debt exposure.
	Tax Treaty shopping	Combination of different Double Tax Treaties (DTT) to divert cross-border payments through low-tax jurisdictions.
Residence-based	Tax deferral	Retaining foreign earnings abroad in order to avoid repatriation of income.
	Corporate inversions & HQ location	Changing corporation's residence or inverting the group roles in order to shape tax residence in the most favorable way

Source: IMF[27]

[27] BEER S., DE MOOIJ R., LIU L. *International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots*. IMF. 2018.

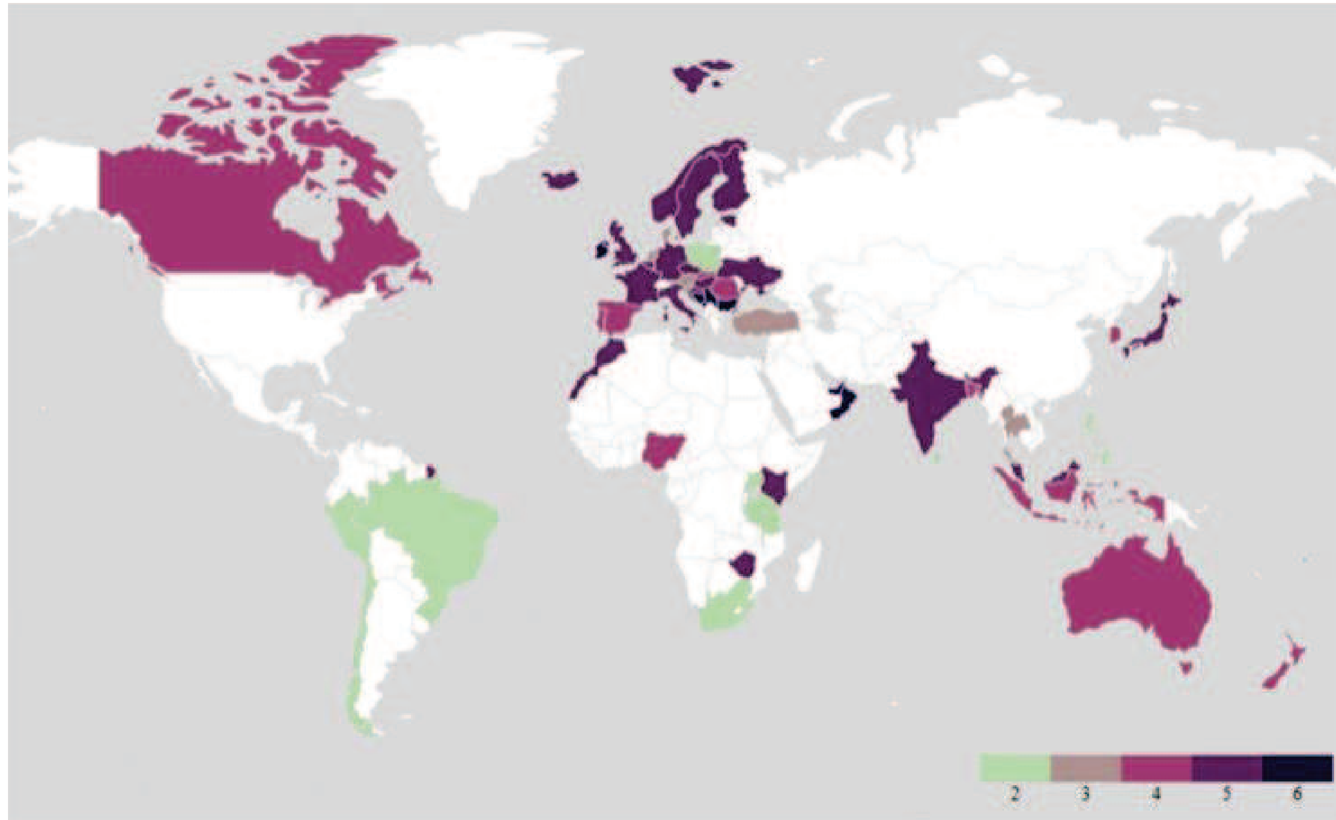
3.1.4. EMPIRICAL EVIDENCE: THE ROLE OF INTANGIBLES IN PROFIT SHIFTING

In 2021, ONGENA S., DELIS M., LAEVEN L., and DELIS F., researchers and professors from different European institutions, conducted an analysis to investigate the existing relationship between MNEs' share of intangible assets and the volume and intensity of profit shifting practices.[28]

In specific, they constructed, through non-parametric estimation, a global profit-shifting database including measures for profit shifting with regard to years and subsidiaries across 95 different countries, analyzing the period from 2009 to 2017. It emerged that profit shifting volumes started gradually decreasing after 2011, probably due to the imminent initiative of BEPS project by OECD, which was launched in 2013. In addition, the database showed that the subsidiaries which receive the largest amounts of profits shifted are located in tax havens, such as Cayman Islands and Bermuda. The following map (*Fig. 7*) will show the average amount of shifted profits received by each country worldwide.

[28] ONGENA S., DELIS M., LAEVEN L., DELIS F. *Global evidence on profit shifting: The role of intangible assets*. CEPR. 2021.

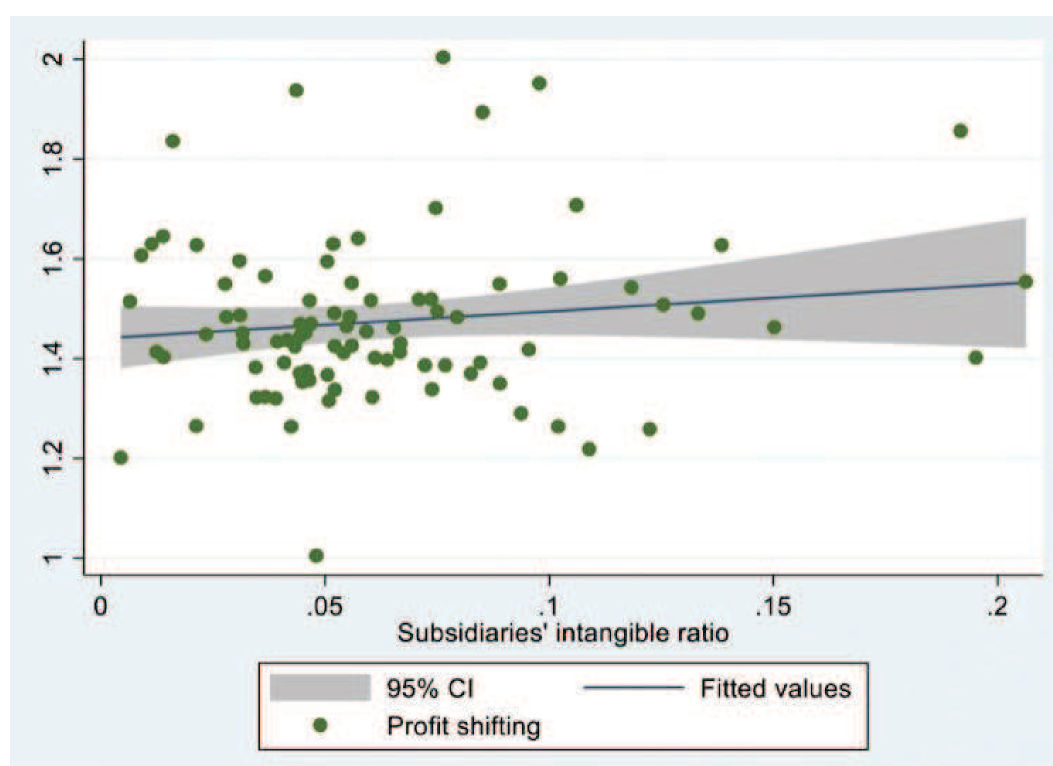
Fig. 7: Average amount of profit shifting volumes to each country, 2021.



Source: CEPR

In addition, a positive correlation was found between the share of intangible assets owned by a subsidiary (e.g. the ratio between intangible assets and total assets owned) and the volumes of profit shifting put in place towards the same company. Such positive correlation is shown in the following graph (*Fig. 8*).

Fig. 8: Positive correlation among intangible assets shares and profit shifting.



Source: CEPR

In specific, data showed that a 1% standard deviation in the ratio between intangible assets and total assets results in a 4,4% increase in profits shifted. In other words,

the more intangible assets a firm owns relative to its total asset, the more it will likely implement profit shifting techniques. That explains the relevance of strategic use of intangible assets for BEPS purposes.

3.2. REGULATORY COMPLEXITY

The intensification over time of international trade, with the birth and stable growth of Multinational Enterprises, has contributed to increase the already existing complexity of the economic environment. In fact, since MNEs usually conduct business across a huge variety of countries, many complex taxation issues have emerged. Those issue strongly affect tax administrations: given the differences in taxation systems and regimes across countries, it’s extremely difficult for regulators to determine income and expenses of multinational companies’ divisions operating in different countries, especially where intercompany transactions are highly integrated. Nevertheless, in parallel, problems arise for MNEs too. In fact, the obligation to converge to several laws and standards varying from country-to-country results in huge compliance costs and the risk of double taxation.

From a tax administration perspective, the concerns arising from the taxation of MNEs cannot be solved by applying single countries’ norms isolated but need to be addressed from a broader international perspective.

3.2.1. OECD MODEL TAX CONVENTION

In 1963, OEDC issued "*Draft Double Taxation Convention on Income and on Capital*", which then became "*OECD Model Tax Convention on Income and on Capital*". Its primary goal was to address the issue of double taxation, defined as the taxation of the same income in more than one jurisdiction, by providing standards and tools to efficiently allocate taxing rights among different countries. The convention underwent several changes over time: the first relevant update was in 1977, with the clarification of the notion of Permanent Establishment (PE), contained in Art. 5, and defined as "*a fixed place of business through which the business of an enterprise is wholly or partly carried on*". That was a milestone for the taxation of Multinational Enterprises operating in different countries. Subsequent revisions and updates were issued in 1992, 1994, 1997, 2000, 2003, 2008, 2010, 2014, and 2017.

For the interest of the analysis, Art. 9 *Associated Enterprises* is particularly relevant. Its objective is to ensure that cross-borders transactions among related entities occur at arm's length prices. It states as follows:

1. *"Where:*
    a) *an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or*

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

2. *Where a Contracting State includes in the profits of an enterprise of that State — and taxes accordingly — profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first-mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the*

competent authorities of the Contracting States shall if necessary consult each other."[29]

Whereas paragraph 1 provides the definition of associated enterprise (points a and b) and establishes arm's length principle as the governing standard for intercompany transactions, paragraph 2, added in the 1977 version, calls tax authorities to implement adjustment if that condition is not met. Those adjustments could include transactions' recharacterization or reallocation of income and costs.

3.2.2. OECD TRANSFER PRICING GUIDELINES

The conclusions of Art. 9 of OECD Model Tax Convention are pointed out in *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, approved and adopted by OECD Council in 1995. It is a set of guidelines intended to provide guidance for the correct application of arm's length principle in setting transfer prices. OECD Guidelines are structured in ten chapters, each of which analyzes a different topic related to transfer pricing. The chapters and their focus are presented in the following table (*Tab. 9*).

[29] OECD Model Tax Convention on Income and on Capital. Art. 9. 2017 (*update*).

Tab. 9: OECD Guidelines on Transfer Pricing: Structure.

CHAPTERS	TITLE/FOCUS
Chp. I	The *arm's length principle*
Chp. II	Transfer pricing methods
Chp, III	Comparability analysis
Chp. IV	Administrative approach to avoiding and resolving transfer pricing disputes
Chp. V	Documentation
Chp. VI	**Special considerations for intangibles**
Chp. VII	Special considerations for intra-group services
Chp. VIII	Cost contribution arrangements
Chp. IX	Transfer pricing aspects of business restructuring
Chp. X	Transfer pricing aspects of financial transactions

Source: OECD[30]

3.2.3 CHAPTER VI: SPECIAL CONSIDERATIONS FOR INTANGIBLES

As highlighted in the table, for the interest of the analysis, the focus will be posed on Chapter VI, *Special considerations for intangibles*. The chapter recalls Art. 9 of

[30] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. 2022 (*update*).

OECD Model Tax Convention, starting from the provided conditions for transactions between related entities in order to analyze the role of intangible assets in those transactions. To cite directly OECD: "*The purpose of this Chapter VI is to provide guidance specially tailored to determining arm's length conditions for transactions that involve the use or transfer of intangibles.*"[31]

3.2.3.1 SECTION A: IDENTIFYING INTANGIBLES

The starting point is the identification of intangible assets, for which Chapter VI provides a detailed definition: "*the word "intangible" is intended to address something which is 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*".[32] Such a definition is important because, as specified in Paragraph 6.7, there are intangible assets which are relevant for transfer pricing purposes, that may be not recognized as intangibles by accounting principles. Examples could be costs associated to internally develop intangibles, such as R&D costs or advertising costs, which are often expensed and

[31] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VI – *Special considerations for intangibles*. Paragraph 6.2. 2022 (*update*).
[32] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VI – *Special considerations for intangibles*. Section A.1. Paragraph 6.6. 2022 (*update*).

not capitalized, thus not reflected in companies' balance sheets. Moreover, because of the existence of relevant intangibles which cannot be transferred singularly, but only in combination with other assets, separate transferability is not a condition for the characterization of an intangible assets for transfer pricing purposes. Therefore, a functional analysis needs to be performed in order to determine which are the relevant intangible assets for a given MNE, how they contribute to value creation for the company, functions performed, and risks associated to the development, use, and protection of those assets. That analysis serves as a support for the determination of arm's length conditions for transactions involving those assets. In addition, Chapter VI provides a classification of intangible assets for transfer pricing purposes. It distinguishes between *marketing intangibles* and *trade intangibles*. The respective definitions are provided in *Tab. 10.* Also, Paragraph 6.17 introduces the notion of *unique and valuable intangibles*, intended as "*those intangibles (i) that are not comparable to intangibles used by or available to parties to potentially comparable transactions, and (ii) whose use in business operations […] is expected to yield greater future economic benefits than would be expected in the absence of the intangible*".[33] The chapter also provides illustrations of the most common intangible assets considered for transfer pricing purposes. They are *patents*, *know-how and trade secrets*, *trademarks, trade names and brands*, *rights*

[33] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VI – *Special considerations for intangibles*. Section A.3. Paragraph 6.17. 2022 (*update*).

under contracts and government licenses, *licenses and similar limited rights in intangibles*, *goodwill and ongoing concern value*, *group synergies*, and *market specific characteristics* (see *Tab. 11*). It is specified that the list does not include all the possible intangibles used for transfer pricing purposes, its goal is to provide a template on the basis of existing experience. For this reason, the list and the related definitions cannot substitute the specific functional analysis mentioned above, since in any case it needs to be adjusted to the specific regulatory environment of each single tax jurisdiction.

Tab. 10: Marketing Intangibles and Trade Intangibles.

Marketing Intangibles	An intangible (within the meaning of paragraph 6.6) that relates to marketing activities, aids in the commercial exploitation of a product or service and/or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, for example, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used or aids in marketing and selling goods or services to customers.
Trade Intangibles	An intangible other than a marketing intangible.

Source: OECD[34]

[34] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. *Glossary*. 2022 (*update*).

Tab. 11: Illustrations of most common intangibles for TP purposes. [Source: OECD]

Intangibles	Illustrations
Patents	*Legal instrument that grants an exclusive right to its owner to use a given invention for a limited period of time within a specific geography.*
Know-how and trade secrets	*Proprietary information or knowledge that assist or improve a commercial activity, but that are not registered for protection in the manner of a patent or trademark.*
Trademarks, trade names and brands	*A trademark is a unique name, symbol, logo or picture that the owner may use to distinguish its products and services from those of other entities. A trade name may have the same force of market penetration as a trademark and may indeed be registered in some specific form as a trademark. A brand represents a combination of intangibles and other assets, including trademarks, trade names, customer relationships, reputational characteristics, and goodwill.*
Rights under contracts and government licenses	*Government licenses and concessions […] include government grants of rights to exploit specific natural resources or public goods, or to carry on a specific business activity. Rights under contracts […] include contracts with suppliers and key customers, and agreements to make available the services of one or more employees.*
Licenses and similar limited rights in intangibles	*Limited rights in intangibles are commonly transferred by means of a license or other similar contractual arrangement, whether written, oral or implied. Such licensed rights may be limited as to field of use, term of use, geography or in other ways.*
Goodwill and ongoing concern value	*Goodwill is described as a representation of the future economic benefits associated with business assets that are not individually identified and separately recognized. Ongoing concern value is [...] the value of the assembled assets of an operating business over and above the sum of the separate values of the individual assets.*
Group synergies	*Group synergies can take many different forms including streamlined management, elimination of costly duplication of effort, integrated systems, purchasing or borrowing power, etc.*
Market specific characteristics	*For example, high purchasing power [...], low prevailing labor costs, proximity to markets, favorable weather conditions [...], etc.*

3.2.3.2. SECTION B: OWNERSHIP AND D.E.M.P.E.

Section B focuses on intangibles' ownership: understanding which entity or entities within a group are provided with the benefits arising from the exploitation of certain intangible assets is crucial for the determination of arm's length prices, and often challenging for tax administrations. That is associated with the allocation of related costs for development, use, and protection of those assets. In specific: "*The ultimate allocation of the returns derived by the MNE group from the exploitation of intangibles, and the ultimate allocation of costs and other burdens related to intangibles among members of the MNE group, is accomplished by compensating members of the MNE group for functions performed, assets used, and risks assumed in the development, enhancement, maintenance, protection and exploitation (DEMPE) of intangibles according to the principles described in Chapters I-III.*"[35] The section provides standards for the determination of legal ownership, contractual terms, functions, and related risks. All those aspects combined are useful for determining arm's length prices for MNEs' controlled transactions.

[35] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VI – *Special considerations for intangibles*. Section B. Paragraph 6.32. 2022 (*update*).

3.2.3.3. SECTION C: TRANSACTION INVOLVING THE USE OR TRANSFER OF INTANGIBLES

Section C aims to analyze in specific the transactions involving assets which are relevant for transfer pricing purposes. It primarily distinguishes among *transactions involving transfers of intangibles or rights in intangibles* and *transactions involving the use of intangibles in connection with the sale of goods or the provision of services*. The transfer of intangibles can occur both singularly or in combination with other assets: if the latter happens, the need arises for defining the nature and implications of legal and economic relationships between different assets, since it is possible that a single asset is more valuable in combination with others rather than if considered separately. Moreover, it's necessary to ensure that all intangibles transferred within a given transaction are identified and evaluated. In fact, there are intangible assets whose transfer is not possible in isolation, but only within a combination with other assets (think to goodwill assets, see *paragraph 1.2.3*). For this reason, it is crucial for regulators to clearly identify all the assets made available to the other entity. If, instead, the transfer is about rights in intangibles, it may involve the whole of rights in certain intangibles, or limited rights in them. It is thus fundamental to identify the nature of the transferred rights and, where limited rights are transferred, also the nature and extent of such limitations. In addition, it's possible to identify transactions in which intangibles are transferred in combination with other business transactions, meaning in combination with tangible business

assets or services. An example may be the transfer of software rights combined with the undertaking by the transferor of software maintenance and update services. If that's the case, it's important to understand which intangible assets are connected to a specific "tangible/service transaction", in order to identify and take into account all the intangibles transferred within the combination. In some situations, it is possible to separate the tangible and intangible parts of those combinations, and therefore to determine arm's length conditions by disaggregating them. Nevertheless, that scenario is not frequent, therefore it's necessary to determine arm's length prices on an aggregate basis.

On the other hand, it is possible to identify transactions that involve the use, and not the transfer, of intangible assets. That occurs when intangibles are used in combination with the sale of goods or performance of services. That's the case, for instance, when a car manufacturer uses proprietary patented technology to assemble the cars which are then sold or transferred to related distributors. If such a situation arises, regulators need to identify which intangibles have been used in connection with that transaction and assess what portion of the final value they contribute to create.

3.2.3.4. SECTION D: SUPPLEMENTAL GUIDANCE

Section D provides supplemental guidance for the application of arm's length principle in transactions involving intangible assets. In specific, section D.2.1 lists and analyzes the unique features of intangibles, which need to be addressed in performing a comparability analysis. Those features involve aspects such as:

- Exclusivity
- Extent and duration of legal protection
- Geographic scope
- Useful life
- Stage of development
- Rights to enhancements, revisions, and updates
- Expectation of future benefit

In addition, the section provides standards for the selection and application of the most appropriate transfer pricing methods to transactions involving intangible assets. The appropriateness of one method with respect to the others depends upon three main considerations: *"(i) the nature of the relevant intangibles, (ii) the difficulty of identifying comparable uncontrolled transactions and intangibles in many, if not most, cases, and (iii) the difficulty of applying certain of the transfer pricing methods described in Chapter II in cases involving the transfer of*

intangibles."[36] The methods recalled from Chapter II are Comparable Uncontrolled Price (CUP) Method, Resale Price Method (RPM), Cost-Plus Method, Transactional Net Margin Method (TNMM), and Transactional Profit Split Method (TPSM). CUP Method, RPM, and Cost-Plus Method are defined as traditional transaction methods, and they have been previously presented and studied in *Chapter 2* (see *paragraph 2.2.4*). On the other hand, TNMM and TPSM are called transactional profit methods, since the analyze profits deriving from controlled transactions among related companies. Those profits represent a relevant indicator of eventual differences in conditions between those kinds of transactions and comparable uncontrolled situations. In specific, Transactional Net Margin Method (TNMM) considers the net profits realized by a taxpayer from a controlled transaction, which is then compared with the net profits arising from comparable uncontrolled transactions. Therefore, it's application is similar to what stated for RPM and Cost-Plus Method. The advantage of TNMM, and transactional profit methods in general, with respect to traditional methods, is that profits, rather than prices, are less affected by transactional and functional differences among controlled and uncontrolled transactions. Nevertheless, TNMM also presents some weaknesses: first of all, it requires the availability of information which may not be

[36] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VI – *Special considerations for intangibles*. Section D.2.5. Paragraph 6.131. 2022 (*update*).

available at the time of the analyzed transactions. In addition, net profits are influenced by a series of factors, such as interest expenses or amortization costs, that would instead have no or little influence on prices, gross margins, and markups, which are the indicators used by traditional transaction methods. Transactional Profit Split Method, instead, seeks to establish arm's length conditions for controlled transaction by splitting profits among associated enterprises on the basis of their contribution to the generation of those profits. Specifically: "*The method first identifies the profits to be split from the controlled transactions – the relevant profits – and then splits them between the associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm's length. As is the case with all transfer pricing methods, the aim is to ensure that profits of the associated enterprises are aligned with the value of their contributions and the compensation which would have been agreed in comparable transactions between independent enterprises for those contributions.*"[37]

The main advantage provided by TPSM is that its application is particularly useful in cases when both parties involved in controlled transactions make unique and valuable contributions to it, but also in cases of highly integrated entities, for which a one-sided approach, as the one proposed by traditional methods, would be

[37] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter II – *Transfer pricing methods*. Section C.1. Paragraph 2.114. 2022 (*update*).

ineffective. Still, the method presents one important weakness, which is related to the difficulty of its application. In fact, tax administrations could find it extremely difficult to assess the necessary data, such as relevant revenues and costs for all the associated enterprises joining controlled transactions. It may be also difficult to detect the relevant operational costs and to allocate them correctly across the different divisions and transactions.

In addition, section D.4 of Chapter VI introduces the notion of *Hard-To-Value Intangibles* (HTVI), defined as: "*intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist, and (ii) at the time the transactions was entered into, the projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer*".[38] HTVI's common features are the following:

- Partial development at the time of the transfer
- No expectation for commercial employment
- Absence of similar intangibles (e.g. new knowledge-based intangibles)
- Transfer through lump sum payments

[38] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VI – *Special considerations for intangibles*. Section D.4. Paragraph 6.189. 2022 (*update*).

- Combination with or development under *Cost Contribution Arrangements* (CCA) or similar

N.B. "A CCA is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create benefits for the individual businesses of each of the participants."[39]

When dealing with HTVI, asymmetric information between taxpayers and regulators contributes to sharpen the difficulties in determining arm's length conditions for controlled transactions.

3.2.3.5. ANNEX II: GUIDANCE FOR HTVI

Action 8 of *BEPS Package* addressed the need for the issuance of transfer pricing standards and corrective measures for transactions involving *Hard-To-Value Intangibles*. The outcome was contained in the *2015 BEPS Action 8-10 Final Report*, titled "*Aligning Transfer Pricing Outcomes with Value Creation*". In 2018, that Report was finally incorporated into *OECD Guidelines for Transfer Pricing*, in the form of Annex II to Chapter VI, "*Guidance for tax administrations on the*

[39] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Chapter VIII – *Cost contribution arrangements*. Section B.1. Paragraph 8.3. 2022 (*update*).

application of the approach to hard-to-value intangibles": asymmetric information associated to HTVI implies difficulties for regulators to verify a priori the developments or events which are relevant for the pricing of those assets. Therefore, the goal of the report is to provide guidance to tackle those information asymmetries. HTVI approach is defined as follows: "*In the case of intangibles which fall within the definition of HTVI found in paragraph 6.189, and under certain conditions, tax administrations are entitled to consider ex-post outcomes as presumptive evidence about the appropriateness of the ex-ante pricing arrangements*".[40] In practice, if, for instance, actual revenues or cash-flows (ex-post) associated to a given HTVI are higher than the revenues or cash-flows expected at the early stage, on which actual arm's length price estimates have been based, then regulators have presumptive evidence (e.g. evidence deriving from empirical inference) that the anticipated revenues or cash-flows should have been higher. That requires attention in assessing what was known at the time when the predictions were made, and which development or events happened next. For this reason, tax administrations should take into account any available information possibly related to a specific HTVI transaction. Furthermore, HTVI approach implies timing concerns: it is not rare that the time intercurrent between the transfer

[40] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. Annex II to Chapter VI – *Guidance for tax administrations on the application of the approach to hard-to-value intangibles*. Section 1. Paragraph 6. 2022 (*update*).

of HTVI and the emergence of ex-post outcomes may be substantially different from administrative and auditing timings. Such issue is even more problematic in the case of assets having a long incubation period, intended as the period of time between the transfer of the asset and its commercial availability.

Finally, it is important to highlight that HTVI approach is also aimed at promoting tax certainty for taxpayers, therefore it must be applied in a way that avoids the risk of double taxation arising from the required adjustments.

4. THE INDITEX CASE

In *Chapter 3*, the strategic role of intangible assets for transfer pricing purposes has been studied in detail. Also, the further complexity of the regulatory environment has been presented, including the main corrective measures which were undertaken by tax administrations. In the present chapter, a step closer will be made, through the study of a real case: the Inditex case.

4.1. INDITEX: OVERVIEW

4.1.1. COMPANY PRESENTATION

Inditex (*Industria de Diseño Textil*) S.A. is a Spanish multinational group operating in the fashion industry, founded by Amancio Ortega in 1985. At the time, it was only represented by Zara brand; nevertheless, between 1991 and 1999, other brands such as Bershka, Massimo Dutti, Pull&Bear, and Stradivarius joined the group. The list of brands under Inditex S.A. is reported in *Tab. 12*. Over time, the group has experimented a rapid growth, becoming one of today's largest fashion retailer worldwide. Its success is primarily due to the implementation of so-called *fast-fashion business model*: its definition is provided in *Fig. 9*.

Tab. 12: Brands under Inditex S.A.

Brand	Year of incorporation
Zara	1975
Pull&Bear	1991
Massimo Dutti	1991 (acquired)
Bershka	1998
Stradivarius	1999 (acquired)
Oysho	2001
Zara Home	2003
Uterque*	2008

Source: Inditex

**N.B. Uterque was integrated into Massimo Dutti in 2021.*

Fig. 9: Fast-Fashion Business Model.

Source: Investopedia

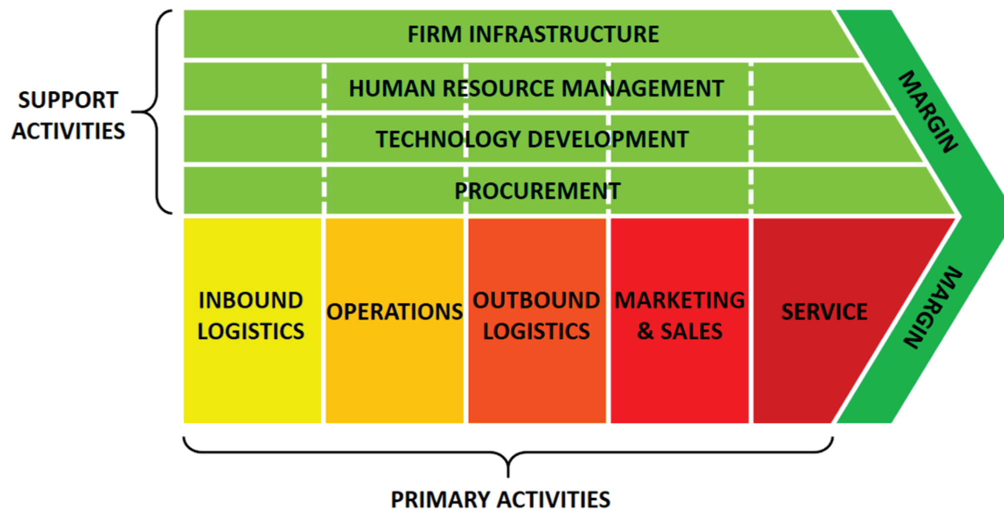
Fast-fashion business model can be therefore summarized in four main features:

- trend replication
- rapid production
- low quality
- competitive pricing

4.1.2. STRUCTURE AND VALUE CHAIN

The value chain model was first theorized by Michael Porter in its work titled "*Competitive Advantage: Creating and Sustaining Superior Performance*" (1985). Corporate value chain is intended as the set of business activities and processes that a company needs to perform in order to create and sell a product. According to the model, a given firm is disaggregated into its strategically relevant activities in order to assess cash-flows and their relevant sources. Each organization is therefore broken down into nine main processes, five of which are defined as primary activities, whereas the other four are referred to as supportive activities. The general scheme of corporate value chain model is illustrated in *Fig. 10.*

Fig. 10: Corporate Value Chain Model.



Source: Porter, 1985[41]

Let's take a look in specific to each activity:

1. Primary Activities:

- Inbound logistics: process of receiving, storing, and allocating inputs (e.g. raw materials, components, information, etc.) needed for manufacturing.
- Operations: all the activities aimed at transforming inputs into outputs (e.g. finished products, services).
- Outbound logistics: after production, distribution to retail and sales centers.
- Marketing & sales: activities performed in order to sell and distribute final products or services to customers.

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[41] PORTER M. *Competitive Advantage: Creating and Sustaining Superior Performance.* 1985.

- Service: activities related to sales support, assistance, and customer care, aimed at generating and increasing customer satisfaction.

2. Supporting Activities:

- Procurement: process of acquiring goods, services, materials, and any other inputs needed to fulfill corporate operations. It is arguable that, for fashion companies like Inditex, which strongly rely on their global network of suppliers for the acquisition of raw materials and other inputs, procurement becomes a primary activity, since it has a relevant impact on company's manufacturing and distribution processes.
- Technology development: R&D activities performed to create innovation, which can increase the efficiency and effectiveness of products, processes and operations.
- Human Resource management: activities for the management of corporate workforce. They include selection, recruiting, motivation, training and development, and retaining of employees.
- Firm Infrastructure: internal support and control functions and systems that allow firms to operate efficiently.

It is relevant to notice that Inditex S.A. is a vertically integrated group, meaning that it directly controls most of the stages of its value chain. The stages under its direct control and management are product design, manufacturing and supply, logistics and distribution and retail activities. They are reported and analyzed for the group in *Tab. 13*.

Therefore, from the analysis of Inditex value chain it is possible to derive the key elements of the group's structure. The first aspect is that Inditex operates under centralized control, meaning that relevant strategic decisions (for instance, branding or investment decisions) are taken at the corporate level; nevertheless, execution is decentralized: each brand is provided with high degrees of independence in areas such as design and store activities. In fact, Inditex organizes operations in brand-based divisions: each division is composed by a brand or group of brands and has its own dedicated team for the execution of primary activities. In addition to that, the group also includes some functional departments, which provide support and stability to the organization. Their main functions include finance, human resource management, knowledge management, technology development among others.

To have an idea of Inditex group's composition, the diagram in *Fig. 11* groups Inditex companies by function back in 2014.

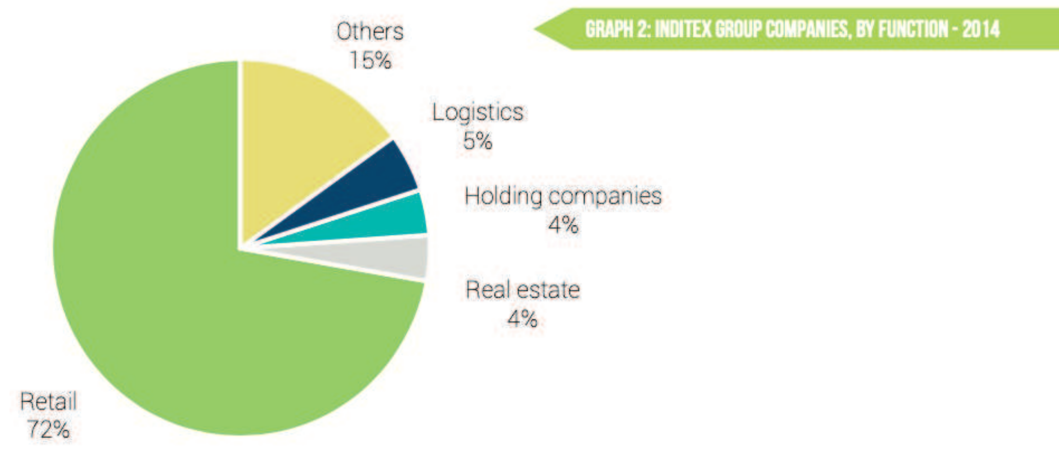
Tab. 13: Inditex value chain stages: flexible, integrated, and innovative model.

Stage	Description
Product design	More than 700 designers across all brands, part of the commercial team which studies consumer preferences, fashion trends, and market events. That results into live collections which can rapidly adapt to changes in consumers' tastes. Focus on sustainability.
Manufacturing and supply	Socially responsible supply chain management: adequate working conditions for employees. Global supply chain, but emphasis on areas near to design centers in order to guarantee tempestive adaptation in case of changes in market trends. That results in minimizing surplus goods (responsible stock management).
Logistics and distribution	Integration and brand centralization: each brand has its own centralized logistics centers in which stocks are held and distributed to stores and online stockrooms. Focus on customers: they can make their buying decisions in their preferred environment (online or in store). Innovative and integrated buying experiences. Proprietary inventory management system through radio frequency identification (RFID).
Retail	Physical stores are built in attractive locations and with quality design, in order to enhance customer experience. The online store is instead aimed at extending the fashion experience by making it available anytime and anywhere through mobile devices. Commitment to technological innovation: looking for innovative solution that entail faster adaptation to continuous changes.

Source: Inditex[42]

[42] Inditex S.A. *2020 Annual Report*. 2020.

Fig. 11: Inditex firms by function, 2014.



Source: The Greens/EFA Group[43]

4.1.3. GLOBAL REACH AND ECONOMIC RESULTS (2023)

Inditex currently operates in 213 markets worldwide, and executives expect a further growth. *Tab. 14* reports Inditex online and in-store sales, as a percentage of the total sales, by geographical area in the first half of 2023, and compares them with the ones from the first half of 2022.

[43] TATARET M., ANGUSTO J. The Greens/EFA Group in the European Parliament. *Tax Shopping: Exploring Zara's Tax Avoidance Business*. 2016.

Tab. 14: Inditex online and in-store sales by geographical area: 2022-23 transition.

Area	1H2023	1H2022
Europe ex-Spain	47.8%	46.3%
Americas	19.4%	20.1%
Asia & RoW	18.4%	19.4%
Spain	14.4%	14.2%
Total	100%	100%

Source: Inditex[44]

Moreover, in the third quarter of 2023, new stores openings took place in 36 different markets, getting the company to a total number of 5722 operating stores at the end of the period. *Tab. 15* shows a list of total stores by brand for that period.

Tab. 15: List of Inditex total stores by brand. [Source: Inditex].

Brand	October 31st, 2023	October 31st, 2022
Zara	1827	1988
Zara Home	410	456
Pull&Bear	789	858
Massimo Dutti	545	605
Bershka	856	957
Stradivarius	847	920
Oysho	448	523
Total	**5722**	**6307**

[44] Inditex S.A. *Interim Half Year 2023 Results*. 2023.

As argued in the beginning of the chapter, Inditex has experienced a stable growth over time, and it's today one of the most successful and profitable fashion companies in the world. In fact, in 2023, the group's sales grew up to €25.6 billion, a 11.1% (14.9% in constant currencies) growth with respect to 2022. Gross profits were €15.2 billion, experiencing a 12.3% increase as compared with 2022; whereas gross margin arrived at 59.4%, an increase by 67 basis points (bps) as opposing to the previous year. On the basis of those considerations, the final gross margin for 2023 is expected to be even higher (+75 basis points with respect to 2022 final gross margin). In addition, in the same period, operating expenses grew by 10.6%, below sales growth (in either case, 11.1% or 14.9% in constant currencies); therefore, the company controlled its expenses efficiently relative to sales growth. *Tab. 16* provides a synthesis of Inditex financial results as of the third quarter of 2023.

Tab. 16: Breakdown of Inditex financial results.

Million €	9M2023	9M2022
Net financial income (losses)	219	13
Lease financial expenses	-142	-76
Foreign exchange gains (losses)	-79	-107
Total	**-2**	**-171**

Source: Inditex[45]

[45] Inditex S.A. *Interim Nine Month 2023 Results – 1 February 2023 to 31 October 2023*. 2023.

4.2. INDITEX TAX AVOIDANCE CASE

4.2.1. THE GREENS/EFA GROUP

The first case addressing Inditex S.A. aggressive tax avoidance strategy was levied by *The Greens/European Free Alliance*, a political group which was founded in 1999 by the joining forces of *The Greens* and *European Free Alliance* (EFA) in the European Parliament. With 72 members from across Europe, it is the fourth largest group in the EU Parliament. Its goal is to "*make Europe the global leader in terms of climate and environmental protection, peace and social justice, fair globalization, and in the fight for human rights, and self-determination*".[46]

It aggregates several groups of different political orientations, mainly environmentalist, progressivist, and regionalist, such as the *European Greens*, part of the *European Free Alliance* (EFA), the *European Pirate Party*, *Volt Europa*, and part of *Animal Politics EU*.

4.2.2. THE ACCUSATION

In 2016, The Greens/EFA Group published a report on tax avoidance strategies by Inditex group, titled "*Tax Shopping: Exploring Zara's Tax Avoidance Business*". In the document, it was argued that "*Inditex has saved at least €585 million in taxes*

[46] The Greens/EFA Group in the European Parliament. *Who We Are – Our Group.*

during the period 2011-2014, by using aggressive corporate tax avoidance techniques, mainly in the Netherlands, Ireland and Switzerland"[47].Those techniques implemented by Inditex, even if legal at the time, levied up several concerns whether the company paid taxes in the places where the real economic activities took place and the relevant value for the group was generated. The first step is determining the role of the mentioned countries, Netherlands, Ireland, and Switzerland, in Inditex corporate strategy, and the reasons why the group chose them specifically. In the report, the following was found:

- Netherlands: Inditex retail divisions paid high royalty fees to a subsidiary located in the Netherlands, where royalties were taxed at the relative low rate of 15%. It was found that, in the analyzed period (2011-14), the Dutch subsidiary in object collected revenues for €3.7 billion, generating a net income of €1.7 billion, having a total of only 203 employees (2014).
- Ireland: Inditex exploited Irish financial subsidiaries and an e-commerce subsidiary to shift huge amounts of profits in Ireland through intercompany loans, where they were relatively low taxed at 12.5%. Furthermore, under the Irish fiscal jurisdiction, capital gains, which are gains deriving from the trade of financial assets, were taxed at 0%.

[47] TATARET M., ANGUSTO J. The Greens/EFA Group in the European Parliament. *Tax Shopping: Exploring Zara's Tax Avoidance Business*. 2016.

- Switzerland: Inditex used one of its main commercial companies located in Switzerland, which bought clothes manufactured in countries such as Bangladesh, Morocco, and Turkey at extremely low costs, then selling them to the other companies of the group at higher prices, therefore registering substantial profits. In fact, in 2014, the Swiss subsidiary owned the most resources in the group (€1.4 billion), and the Swiss tax regime imposed a low tax rate on profits of 7.8% (or even less) in the same year.

4.2.3. INDITEX TAX AVOIDANCE SCHEME IN DETAIL

Fig. 12: Global picture of Inditex tax avoidance scheme.

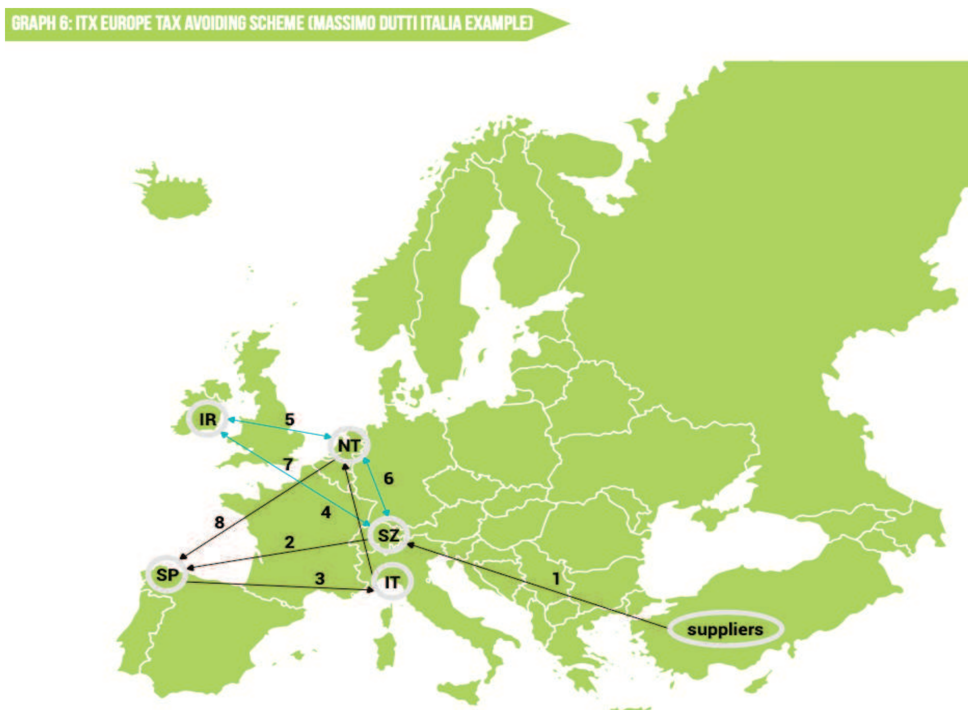


Fig. 12 [Source: The Greens/EFA Group][48] illustrates a global map of tax avoidance strategies implemented by Inditex exploiting different fiscal jurisdictions, by considering the example of Massimo Dutti Italia. The numbers present on the map represent the different controlled transactions strategically put in place by the group to reduce its tax liabilities. They will be studied in detail in the following:

1. Foreign Suppliers to Swiss Subsidiary: the Swiss commercial subsidiary (*ITX Trading*, indirectly owned by *ITX Financien II BV*, in turn a Dutch subsidiary of the also Dutch *Zara Holdings BV*) buys low-cost manufactured clothes from its suppliers in Bangladesh, China, Turkey, Morocco (low-labor-cost countries).
2. Swiss Subsidiary to Spanish Parent Company: *ITX Trading* re-sells those clothes at higher prices to the Spanish parent company of each brand (*Grupo Massimo Dutti S.A.* in the analyzed case), thus realizing a relevant profit margin in a jurisdiction, Switzerland, where profits are taxed at 7.8% or less. That is the first tax avoidance step: maximizing profits in a country with a relatively low corporate tax rate on profits.
3. Spanish Parent Company to Italian Retail Subsidiary: the Spanish parent firm, in turn, sells the purchased clothes to a retail subsidiary in a given

[48] TATARET M., ANGUSTO J. The Greens/EFA Group in the European Parliament. *Tax Shopping: Exploring Zara's Tax Avoidance Business*. 2016.

country, in this case *Massimo Dutti Italia S.R.L.*, which is in charge with the final sale to customers, being therefore a profit generation center.

4. Italian Retail Subsidiary to Dutch IP Holding (Royalties): *Massimo Dutti Italia S.R.L.* pays a royalty fee as a percentage of total sales to a Dutch subsidiary, *ITX Merken*, where *Merken* means *Brands* in Dutch, for the use of its intellectual property or other proprietary assets. The Netherlands' jurisdiction imposes a corporate tax rate on profits of 15%, which is less than the one imposed by Italy (27.5% in 2014 according to OECD statistics). That is the second tax avoidance step: shifting profits from high-tax jurisdictions to lower-tax jurisdictions exploiting differences in international corporate tax rates.
5. Dutch IP Holding to Irish Subsidiaries: Inditex has a complex holding structure in the Netherlands, composed by more than 60 Dutch subsidiaries. Those companies, in turn, acquire different Irish companies, especially insurance, financial, and e-commerce companies, which are therefore able to register elevate profits in terms of acquisition costs, while being taxed at the low Irish corporate tax rate of 12.5%. That's the third tax avoidance step: again, inflating profits, and therefore taxable income, in favorable tax jurisdictions to reduce overall tax liabilities.
6. Swiss *ITX Holding* to Dutch *ITX Financien II BV* (Dividends): *ITX Holding*, a Swiss subsidiary that directly owns the also Swiss *ITX Trading*, pays

dividends to *ITX Financien II BV*, indirect owner of *ITX Trading* (see point 1). Between 2012 and 2014, those dividends amounted to €620 million.

7. Swiss *ITX Holding* to Irish Zara Subsidiary: Swiss *ITX Holding* also owns the Irish company *Zara Financien* and pays dividends to it as explained in the previous point.
8. Dutch Zara Holding to Spanish Parent Company: Part of the generated profits is distributed to the parent company *Inditex S.A.*, headquartered in Spain; the rest is used as capital for self-financing the group's future growth. The payment of dividends to the parent company is done by the Dutch company *Zara Holding BV*, which is the focal point of the whole scheme, since it owns, directly or indirectly, all the Swiss, Dutch, and Irish companies mentioned earlier.

4.2.4. THE ROLE OF INTANGIBLES: FOCUS ON DUTCH ROYALTIES

As argued in the previous paragraphs, Inditex tax avoidance strategy exploited the differences in global corporate tax rates by conducting business mainly in three countries, which are the Netherlands, Ireland, and Switzerland. Nevertheless, for the scope of the analysis, which is to address in specific the role of intangible assets in multinational corporations' tax avoidance strategies, the focus will be specifically on Dutch subsidiaries, since the strategy involving the Dutch

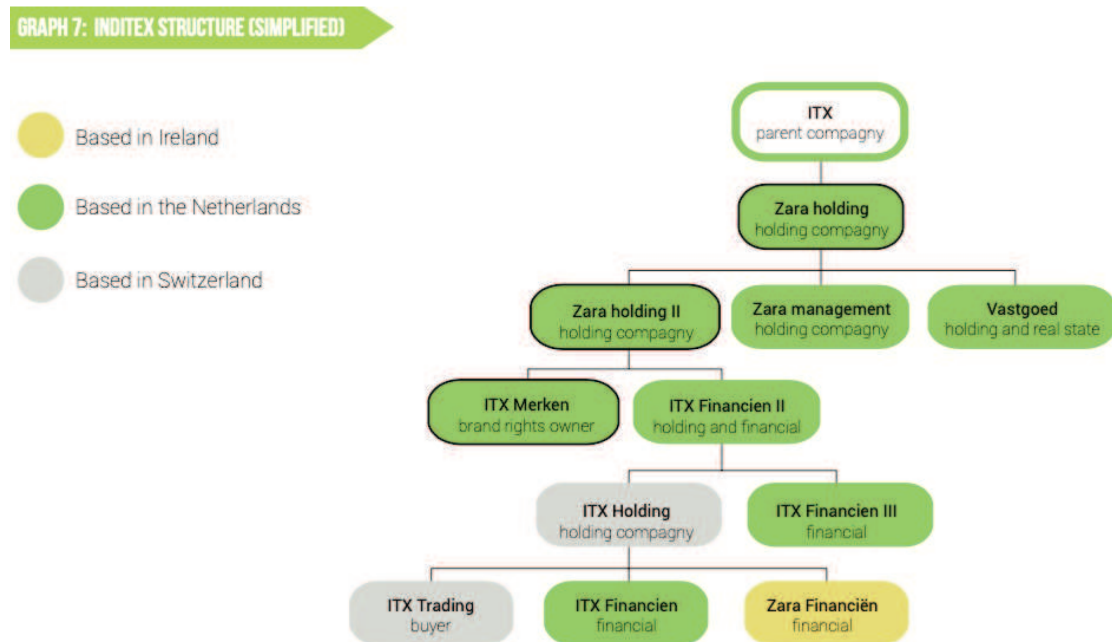
jurisdiction heavily relies on the exploitation of a relevant category of intangible assets, brands and branding rights, and the related royalty fees. The present paragraph is therefore intended to investigate how the group structured itself and operated in the Netherlands.

Several multinational corporations over the years have been moving part of their business to the Netherlands, by establishing holding subsidiaries, especially financial, insurance and licensing companies. The reason for this is that the Dutch tax regime is considered to be extremely flexible, since it offers a wide range of bilateral tax treaties. Moreover, Dutch corporate tax rate experimented a negative trend over time, falling from 35% in 2000 to 25% in 2015 (a 29% reduction), to 12.5% in 2023, getting below the European Weighted Average Corporate Tax Rate (EWACTR) of 24.49% (2023). For those reasons, the Netherlands have been several times under investigation for tax purposes over time (relevant is the Starbucks case).

Looking at Inditex, *Fig. 13* illustrates a simplified structure of the group in the Netherlands. The Greens/EFA study reported that, during the analyzed period (2011-14), the three main Inditex Dutch subsidiaries, analyzed in the previous paragraph, which are *ITX Merken* and the two *Zara Holdings BV* (as marked in the figure), collected a combined income of €3 billion, which is 32% of the group total income in the same period. This means that Inditex has exploited the Netherlands as an operational base for a wide variety of activities, such as the establishment of

holding companies owning other subsidiaries across different countries, financial companies, and IP companies (e.g. branding rights).

Fig. 13: Inditex structure in the Netherlands (simplified), 2014.



Source: The Greens/EFA Group[49]

As stated above, the diagram is simplified, in the sense that it does not consider retail subsidiaries and similar companies which are not useful for the purpose of the analysis.

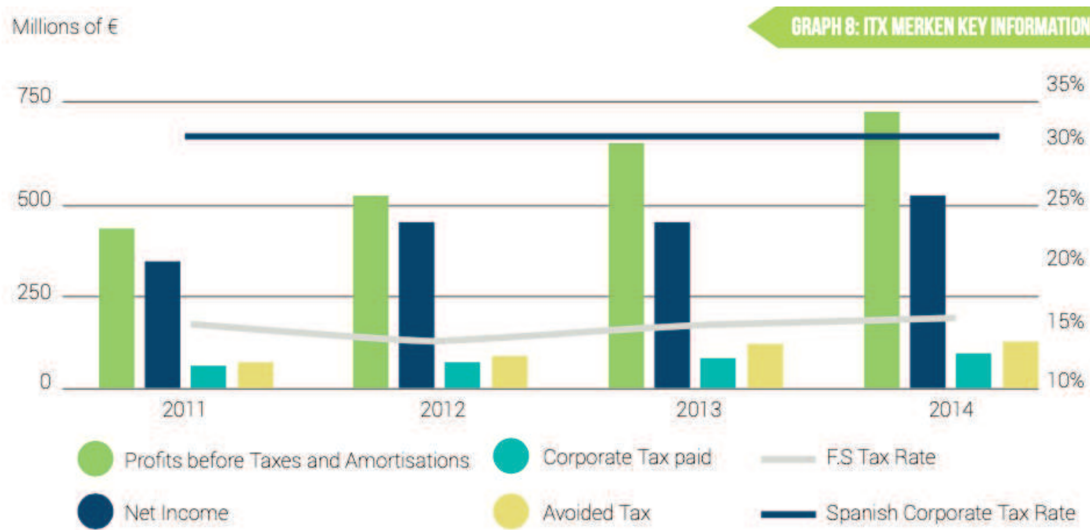
[49] TATARET M., ANGUSTO J. The Greens/EFA Group in the European Parliament. *Tax Shopping: Exploring Zara's Tax Avoidance Business*. 2016.

According to the report, *ITX Merken* is the crucial company for the implementation of Inditex tax avoidance strategy in the Netherlands. The company's main activity is providing franchise contracts for the use of Inditex brands, together with some other complementary activities. The great majority of its income is generated by the collection of royalty payments for the franchise of those brands. In fact, Inditex retail companies pay a share of, assume, 5% on total sales to *ITX Merken* in the form of royalty payments for the use of ITX brands. That must be interpreted as the 5% of total revenues shifted to the Netherlands, where the company pays a relatively low corporate tax of 15% (as opposed to, for instance, the 34% tax rate imposed in Italy at the time). *ITX Merken* registered a net income of €1.95 billion in the analyzed period, collecting a net profit margin of 45%, around 21% of the whole group net income for the same period. Moreover, all that was achieved by only employing 203 people: it means that, on the basis of the presented data, by considering the profit/employee rate, *ITX Merken* generated €2.4 billion per employee in 2014. That sounds weird if considering that the whole Inditex group generates on average just €18 thousands per employee.

From a fiscal perspective, *Fig. 14* provides relevant information of *ITX Merken* financial status for the period 2011-2014: the company paid a total amount of €290 million in corporate taxes, which, even if it was a substantial amount, needs to be weighted by the relatively low corporate tax rate of 15%. In fact, the study estimated that Inditex saved €295 million over the same years by shifting royalties to the

Netherlands. If instead the group would have paid those royalties to the parent company, headquartered in Spain, it would have been taxed at the higher corporate tax rate of 30% at the time. Moreover, branding rights do not produce deductible amortization in Spain, but they do in the Netherlands. Therefore, that is another source of tax savings by Inditex: the group is estimated to have saved around €84 million in tax liabilities due to the amortization of branding rights under the Dutch jurisdiction (as compared with the amount owed if allocating branding rights in Spain). Those two mechanisms – royalties shifting and amortization of branding rights – allowed Inditex to save more than €380 million in overall tax liabilities, facing an effective overall corporate tax rate of just 13%. One more time, by exploiting discrepancies in corporate tax rates across different countries, Inditex was able to substantially lower its overall tax liabilities.

Fig. 14: ITX Merken financial information by year, 2011-2014.



Source: The Greens/EFA Group

Another crucial actor for the implementation of Inditex tax avoidance strategy is *Zara Holding BV*, which is one of the oldest (incorporated in 1988) and biggest holding subsidiaries for the group. The company directly owns more than 40 subsidiaries across different countries, including the Irish, Swiss, and Dutch subsidiaries presented in *paragraph 4.2.3*, such as the latest studied *ITX Merken*, *ITX Holding*, and some others (some of those are indirectly owned). For this reason, it is considered as the converging point of the whole tax avoidance scheme by Inditex. It is in charge with the holding of fashion retail subsidiaries, but it also holds other holding companies and real estate subsidiaries. Within the analyzed period (2011-14), *Zara Holding BV* collected a net income of around €593 million,

paying €473 million in dividends to the Spanish parent company Inditex S.A., by just employing 15 people as of 2014. The interesting aspect is that the company paid €0 in corporate tax years in that period, according to its financial statements. Therefore, it could be argued that, in Inditex tax avoidance strategy, *Zara Holding BV* has the function of being a channel towards Europe, and Spain in particular, for all the revenues generated by its owned subsidiaries located across several different worldwide (China, Canada, United States, Australia, Kazakhstan, Japan, Mexico, and Russia among others).

The last fundamental actor in Inditex strategy is a second holding company, *Zara Holding II BV*. It is another huge subsidiary of the group, by directly or indirectly owning most of the presented companies. For instance, it directly owns *ITX Merken, ITX Financien II BV,* and *ITX Holding.* The company is engaged in the holding of fashion retail subsidiaries, such as the first holding analyzed above. In 2014, it owned also seven companies based in Macau and seven other companies in Hong Kong, both low-tax jurisdictions. Between 2011 and 2014, Zara Holding II BV collected a net income of around €82 million, and its shareholder equity was €509 million, although having exactly 0 employees (2014). It follows that the strategic role of Zara Holding II BV within Inditex structure is to manage a large portion of the group's non-retail subsidiaries (such as ITX Merken or ITX Financien II), which play a crucial role in the group's tax avoidance strategy.

In order to understand the impact of profit shifting through royalty fees, *Fig. 15* analyzes the estimated amount of royalties paid by Inditex retail companies in eight different European countries. What emerges from the figure is that the eight analyzed countries lost more than €452 million in corporate taxes between 2011 and 2014 due to Inditex aggressive tax avoidance strategy through royalty fees shifting. That is a huge social cost, especially if considering that it is relative to a period of just three years. Inditex retail subsidiaries operating in the eight analyzed countries collected in the period an average profit margin of 4%, whereas the whole group average was 14% in the same years. This unequivocally means that a substantial part of the group's profits was shifted from retail companies in those countries to non-retail companies, such as the Dutch subsidiaries previously analyzed, located in favorable tax jurisdictions (the Netherlands in the analyzed case).

Fig. 15: Royalties paid by Inditex in eight European countries.

	Sales	Royalties Paid	Legal Tax Rate 2014	Missing Tax
Spain	14 540,1	727,01	30,0%	218,1
Italy	3 607,5	180,38	31,4%	56,6
France	4 542,5	227,12	33,3%	75,7
Greece	1 503,1	75,16	26,0%	19,5
Austria	454,1	22,70	25,0%	5,7
Germany	1 567,2	78,36	32,3%	25,3
United Kingdom	2 059,2	102,96	21,0%	21,6
Belgium	1 062,0	53,10	34,0%	18,1
TOTAL	**29 768,1**	**1 488,40**		**445,2**

In millions of euros (pounds in the case of the United Kingdom). Aggregated data of the 2011-2014 period.

Source: The Greens/EFA Group

4.2.5. INDITEX DEFENSE

Straight after The Greens/EFA Group accusation in 2016, Inditex rejected the accusation by releasing a statement on its website titled: "*Inditex's response to 'Tax Shopping: Exploring Zara's Tax Avoidance Business' report*". In the statement, the group argued that it has always been complying to the different tax administrations of all the 93 countries in which it operates. Moreover, the company affirmed that its effective tax rate from 2011 to 2015 was among 22 and 24%. To support that thesis, it was stated that, over the same period, Inditex contributed for the generation of €4.4 billion of corporate tax income worldwide, half of which was collected by Spain (€2.2 billion), representing the 2% of the country's total tax revenues for

those years. In addition, the accent was posed on the group's responsible tax conduct and transparency enhancement, arguing that transactions among its subsidiaries are regularly audited by tax authorities of the different countries in object. The statement also reported that Inditex works together with over 400 companies worldwide, and each transaction among them is carried out on arm's length basis and aligning with OECD Guidelines on Transfer Pricing.

Furthermore, to defend against tax avoidance accusations, the group argued that The Greens/EFA Group's report was based on erroneous estimates and misconceptions about Inditex value chain, attaching a list of wrong estimates present in their report, including a description of some of the investigated subsidiaries' core activities.

4.2.6. REGULATORS' RESPONSE

After the publication of *The Greens/EFA Group*'s report, the European Commission took note of it and started investigating on Inditex tax avoidance scheme. The case was called "*Zaraleaks*", and the same day of the publication of the report (December 8th, 2016), the European Commissioner for Economic and Financial Affairs at the time, Pierre Moscovici, argued that tax avoidance accusations against Inditex "*represent a further call for more fiscal*

transparency"[50]. That was a call for EU member countries to rapidly adopt the pending proposals for standards on tax avoidance issues. The most relevant proposal to be adopted was the establishment of a *Common Consolidated Corporate Tax Base* (CCCTB), intended as a common fiscal scheme for all EU member countries. Such framework was proposed by the EU Commission in 2011 but encountered several difficulties in its implementation. In fact, the initial proposal stalled because of the opposition of countries such as Ireland and the UK. Therefore, in 2016, a new CCCTB framework was launched, including two main phases: in the first phase, the goal was for CCCTB to become mandatory for member countries' corporations; whereas the second phase, called *consolidation phase*, was postponed for later proposals. Nevertheless, the consolidation phase in specific faced strong resistance by member countries, indeed, in 2021, the EU Commission decided to finally withdraw the CCCTB proposal, and to replace it with an innovative framework for European corporations. Since then, nothing moved. Another relevant framework Moscovici called for was *Country-By-Country Reporting* (CBCR), first issued in April 2016. It obliges multinational groups with total consolidated revenue equal or greater than €750 million to publicly report net revenues, pre-tax profits, amount of taxes paid, and profits generated in each country in which they operate. The proposal was adopted in July of the same year.

[50] MOSCOVICI P. Twitter (X). 2016.

Despite of those calls for international standardization and transparent reporting, the Inditex case has still not been ruled by the authorities in charge. That's mainly because, according to *Kepler Cheuvreux*, one of the leader European companies for financial services, it seems unlikely that retroactive tax adjustments will be taken for the group's implemented strategy. Nevertheless, future developments of the case are not to exclude, by virtue of other giant multinational groups, such as Amazon, Starbucks, and Apple among others, being investigated for similar reasons in recent years.

CONCLUSIONS

The research has shed light on the complex relationship between intangible assets and tax avoidance strategies. It emerged that Intangible assets, by virtue of their elusiveness and ease of transferability, set the stage for multinational enterprises (MNEs) to exploit regulatory gaps and differences in corporate tax rates across different jurisdictions, thereby reducing their overall tax liabilities.

In such a mechanism, transfer pricing plays a pivotal role for MNEs: they are able to manipulate profits by allocating the greater part of value to intangible assets located in low-tax jurisdictions. By doing this, MNEs can artificially shift profits, by exploiting tax differentials, and minimize their global tax burden.

For this reason, Base Erosion and Profit Shifting (BEPS) techniques, facilitated by the elusiveness of intangible assets, pose significant challenges to international tax administrations. Several efforts have been put in place by regulatory bodies, such as OECD to tackle aggressive tax avoidance strategies by multinational firms. Nevertheless, the today's continuously evolving business environment outpaces regulation, thus leaving regulatory gaps to be exploited by those companies for tax avoidance purposes.

To support the analysis, the Inditex tax avoidance case (2016) has been studied in detail, in order to understand which are the economic, social, and ethical global implications for tax avoidance. In fact, Inditex is a suitable example of how MNEs

strategically exploit intangible assets to optimize their tax positions, specifically, in the presented case, by leveraging royalty fees, shifted to low-tax jurisdictions, such as the Netherlands.

What has finally emerged from the work is that, even if legal, tax avoidance generates extremely high social and ethical costs, since it substantially reduces States' welfare (and, therefore, global welfare) and the confidence towards fiscal institutions, thus affecting the tax morale of individuals and companies.

The fundamental need arises, both from the side of tax administrations and MNEs themselves, for comprehensive tax frameworks aimed at addressing the challenges posed by intangible assets in tax avoidance strategies. In fact, tax authorities, in recent years, were called to develop transparent and internationally standardized frameworks (such as the presented CCCTB and CBCR) for the accounting, reporting, and fiscal treatment of large multinational groups. Nevertheless, international tax administrations are still today far away from reaching that goal: the standards and principle developed so far are showing to be inconsistent, given the fact that still today many firms keep on running aggressive tax avoidance strategies. Yet, numerous cases of multinational groups aggressively avoiding taxes have been found and investigated in the last years, such as Apple, Starbucks, Facebook, and Amazon. The investigation of such case could constitute a relevant regulatory basis on which to insert globally standardized and transparent reporting and accounting principles. Nevertheless, the growing complexity of today's

business environment even increases challenges and problems for policymakers. In fact, today's strongly globalized and digitized business models, its evolution pace, and the growing reliance on intangible assets by increasingly more firms are just some of the main factors which contribute to the creation of regulatory gaps between international tax jurisdictions. Policymakers' priority must therefore be closing those gaps, by enhancing transparency, and, above all, enhancing international cooperation to effectively tackle aggressive tax avoidance frameworks by MNEs. From a multinational company's perspective, instead, ethical considerations must be prioritized: tax position optimization, and therefore profit maximization, is the main goal for every business organization worldwide, and it is legitimate for companies to exploit legal ways to reduce overall tax liabilities and maximize after-tax profits. Yet, in spite of that, tax optimization strategies should not affect stakeholders' welfare; if that happens, tax avoidance strategies appear to be counterproductive: in fact, stakeholders include shareholders, customers, suppliers, and those kinds of business actors, but they also include the civil society. Since stakeholders, and the relationships with them, represent the real engine of firms' competitive advantage, it is not acceptable for companies to point at profit maximization by damaging their social wealth, interests, and needs (social welfare). In conclusion, this study sheds light on the connection between intangible assets, transfer pricing, and tax avoidance strategies. It starts from a comprehensive analysis of theoretical frameworks, then shifting the attention on regulatory

dynamics, to arrive to a real case study which highlights, from the one side (MNEs side) the opportunities created by global differences in corporate tax rates, and in particular by the strategic exploitation of intangible assets; from the other side (Tax administrations side) the challenges hidden behind the taxation of MNEs, with specific regard to intangibles.

It is in everybody's interests (policymakers, firms, civil society) to undertake internationally cooperative efforts, in order to bulid a fair, transparent, and equitable tax environment which, for sure, enhances economic growth, but, at the same time safeguards *our* society.

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