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Centralization of Intangibles and Transfer Pricing under BEPS and Finnish Tax Law

This article discusses principal and holding company structures used by MNE groups, in particular those related to intangibles, including an assessment of such structures under the arm's length principle of the OECD Transfer Pricing Guidelines and Finland's domestic transfer pricing legislation. The article examines the pressure to change existing structures as a result of the OECD BEPS Project.

1. Introduction

Multinational enterprises (MNEs) are typically born as a result of a series of acquisitions and expansions in business operations. A natural consequence of this process is the dispersion of an MNE group's business model, as well as an overlapping of functions. Business objectives, such as management of the MNE group, often call for the replacement of a decentralized model with a more centralized business model. Such changes, however, involve complex tax issues, more specifically transfer pricing issues. Therefore, it is not surprising that principal and holding company structures used by MNE groups to centralize and differentiate their functions have been subject to international discourse. Along with the OECD's BEPS[1] Project and recent tax audits conducted by tax authorities in several countries, it is clear that the structures themselves, as well as related restructurings, have significance both from the perspective of state tax revenue, as well as an MNE group's business and tax considerations.

"Principal model or principal structure" refers to a centralized business and transfer pricing model, which is an alternative to the traditional, decentralized and dispersed model used by MNE groups. In implementing the principal model, the MNE group usually aims to make the group's business planning more efficient and lengthen its planning horizon to facilitate an appraisal of its business profitability and management performance, as well as achieve synergy benefits by eliminating overlapping functions.[2] MNE groups often choose to optimize their legal structure in connection with implementation of the principal model. In addition, centralization of certain types of an MNE group's functions, assets (such as intangibles)[3] and related risks is usually implemented in connection with the principal model.

"IP holding company structure" refers to a structure or a business model pursuant to which an MNE group's most valuable intangibles are centralized under the legal ownership of a fully-owned subsidiary or subsidiaries the main business activities of which consist of ownership and management of the said intangibles. This "IP holding company" does not necessarily carry out any other business functions or employ any personnel. It might, however, have extensive decision-making functions related to, for example, the intangibles it legally owns.

Principal or IP holding company structures can also be used to lower the effective tax rate of the MNE group by locating the company in a jurisdiction where the level of taxation is low or that offers special tax benefits for these types of companies. The objective may also be to reduce the number of intra-group transactions and minimize the risks related to transfer pricing. Principal and holding company structures related to the MNE group's intangibles can be established relatively easily through contractual arrangements. Due to the characteristics of intangibles, they are at least in principle easily transferable, especially in the event no significant costs are associated with the registration of the intangibles under a different controlled company.[4] Contrary to, for example, production and sales activities, taxation may, therefore, be a more significant factor in determining the location of assets and risks related to the intangibles.[5]

This article discusses principal and holding company structures used by MNE groups, including an assessment

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1. The project was commenced in 2013. The OECD published the revisions to the Transfer Pricing Guidelines (OECD Guidelines) in October 2015 as a part of the BEPS Final Reports, available at http://www.oecd.org/ctp/beps-2015-final-reports.htm. *See also* the International Organizations' Documentation collection at https://online.ibfd.org/kbase/.
2. These types of objectives are common for different kinds of centralization activities carried out within MNEs. *See*, for example, the discussion on the centralization of intra-group financing and benefits in A. Isomaa-Myllymäki, *Konsernin sisäisen rahoituksen markkinaehtoisuus. Markkinaehtoperiaatteen soveltamisen oikeudelliset rajoitukset etuyhteysluotonannossa* 6-8 (AlmaTalent 2016).
3. In this article, the authors use a wide concept of intangibles, according to the OECD Guidelines, which covers not only registerable intangible assets, but also other assets that are intangible in nature.
4. A. Quiquerez, *Intellectual Property holding companies: An international legal perspective*, Intellectual Property Quarterly 4, 310 (2013). *See also*, on the characteristics of intangibles, J.R. Markusen, *The boundaries of multinational enterprises and the theory of international trade*, 9 J. of Ec. Perspectives 2, 174 (1995).
5. *See* S. Penttilä, *Ovatko rajat ylittävät verosuunnittelumahdollisuudet rajattomat?* 86-112 (Keskuskauppakamarin Suuri Veropäivä 2007) and M. Raunio, *OECD:n BEPS-projektin vaikutus kansainvälisen yrityksen verotukseen* 115 (Keskuskauppakamarin Suuri Veropäivä 2015).

of such structures under the arm's length principle of the OECD Transfer Pricing Guidelines and Finland's domestic transfer pricing legislation. The article concentrates specifically on principal and holding company structures related to intangibles and the pressure to change existing structures as a result of the OECD BEPS Project. The article does not cover controlled foreign company (CFC) legislation, issues related to permanent establishments (PEs) or the applicability of anti-avoidance legislation. In addition, valuation methods related to intangibles are not discussed.

2. IP Principal and IP Holding Company Structures and Centralization of Intangibles

In the 1990s, companies observed that business models based on centralization were very efficient. As a result, "value chain" thinking became more common.[6] Operating an existing decentralized group as a truly global MNE group requires refining the group's value chain and processes, as well as integration of any acquired companies or businesses into the existing operations.[7] Principal and holding company structures served as a solution to this problem.

In the current business environment, where MNE groups receive the majority of their profits from the utilization of intangibles, centralization of intangibles has growing importance to the group's business activities.[8] MNE groups have several business reasons for centralizing their intangibles. Management of intangibles becomes easier. Centralization enables, for example, more efficient registration of patents, more detailed observation of registration needs, as well as recognition of blind spots of the patent shield, if any. Centralization also facilitates the recognition of potential infringement cases and follow-up in respect of third-party, as well as intra-group, licensing arrangements. In addition, centralization enables the use of intangibles as a guarantee when funding is acquired.[9] The use of IP principal or IP holding company structures also enables the MNE group to protect the intangibles, for example, in the event of insolvency of a group company, as the intangibles will be legally owned by a separate legal entity. The separation of intangibles into principal or IP holding companies may also be a useful preliminary measure in the event the MNE group is preparing for M&A transactions or divestments.[10]

The choice of the most feasible location for centralization of intangibles and principal or IP holding companies depends on multiple factors. The principal company established to manage the MNE group's business activities in an individual market area is usually established near the market area in question. The nature of the functions to be centralized and the infrastructure and logistics these functions require also affect the choice of location. The availability of good traffic connections and an educated workforce, stability of the legal and political environment, as well as that of currency and legislation affect the choice of location. This choice is also affected by the location jurisdiction's tax treaty network, the existence of CFC legislation and specific tax incentives for principal and holding companies (if any).[11] The corporate tax base and tax rate has an impact on the choice as well, as a wide tax base and high tax rate decrease after-tax profit.[12] The applicability of international agreements on intangibles, as well as factors related to withholding taxation of royalties may require special attention.[13] The centralization of intangibles under a separate entity is, however, both legally and commercially feasible as long as aspects related to the protection of intangibles are taken into account.[14]

3. IP Principal and IP Holding Company Structures as a Means to Centralize Intangibles and the Profit Generated by Intangibles

3.1. OECD's BEPS Project and updated OECD Guidelines

In addition to acting as a means to plan the MNE group's business activities, IP principal and IP holding company structures can also be used as a vehicle for tax planning. In situations in which the structures have been used for mainly tax-related purposes, legal ownership of the intan-

6. J. Henshall, *Global Transfer Pricing: Principles and Practice* 118 (2nd ed., Bloomsbury Ltd 2013).
7. *See*, for further details on the reasons for business restructurings, *Transfer Pricing and Business Restructurings: Streamlining all the way* 3 et seq. (A. Bakker ed., IBFD 2009).
8. *See* Henshall, *supra* n. 6, at 118. *See also*, on the significance of intangibles in the formation and operation of multinational groups, R.A. Jr. Matthews, *A Potential Hidden Cost of a Patent-Holding Company: The Loss of Lost-Profit Damages*, 32 AIPLA Quarterly J. 4, 504 (2004); P.S. Chestek, *Control of Trademarks by the Intellectual Property Holding Company*, 41 IDEA The J. of Law and Tech. 1, 8 (2001); M. Dischinger & N. Riedel, *Corporate taxes and location of intangible assets within multinational firms*, J. of Public Ec. 95, 691-692 (2011); and J.R. Markusen, *The boundaries of multinational enterprises and the theory of international trade*, 9 J. of Ec. Perspectives 2, 171 et seq. (1995) and V. Gattai, *Firm's Intangible Assets and Multinational Activity: Joint-Venture Versus FDI*, Fondazione Eni Enrico Mattei Working Paper Series, No. 122.2005 (Oct. 2005), Bocconi University and ISESAO.
9. *See*, for example, T. Frick & M. Kronauer, *Benefiting from a Swiss-based IP company*, Intl. Tax Rev., 32-33 (2005); Quiquerez, *supra* n. 4, 307-308, Matthews, *supra* n. 8, at 504, Chestek, id., at 8 and R. Jaakkola et al., *Siirtohinnoittelu käytännössä* 239 (Edita Publishing Oy 2012). The *2017 OECD Guidelines* (OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2017), International Organizations' Documentation IBFD [hereinafter *2017 OECD Guidelines*]) also recognize the business reasons for centralization of intangibles; *see*, for example, para. 9.58.
10. Quiquerez, *supra* n. 4, at 307-308 and 318-319.
11. These factors were discussed from Switzerland's point of view in T. Sauvaire & A. Müller, *How Switzerland attracts international headquarters*, Intl. Tax Rev., 21 et seq. (Apr. 2006).
12. *See* Henshall, *supra* n. 6, at 119. It has been empirically proven that multinational groups centralize their intangibles in states with a low business tax rate. CFC legislation and withholding taxation of royalties also affect the choice of jurisdiction. *See* T. Karkinsky & N. Riedel, *Corporate taxation and the choice of patent location within multinational firms*, J. of Intl. Economics 88, 177 and 182-185 (2012) and Dischinger & Riedel, *supra* n. 8, at 691.
13. *See also* T. Valoir, *Exploring the Intersection between Tax and Intellectual Property*, Taxes – The Tax Magazine 21 (Dec. 2007), who pays attention to the fact that the legislation on the protection of intangibles in countries with a low tax rate is not necessarily comprehensive.
14. *See*, on the different objectives of tax planning and protection of intangibles, for example, Valoir, id., at 19. *See*, for more detail on risks related to transfers of patents from a US perspective Matthews, *supra* n. 8, at 505-506 and 513 et seq., as well as K. Feisthamel & M. Hall, *Parent or Subsidiary? Think Twice Before Opting Not to Have the Parent Own the Trademark*, IPWatchdog (24 July 2016).

gibles has been transferred to the principal or IP holding company only on a contractual basis.[15] One of the main goals of the OECD's BEPS Project and the revised OECD Guidelines[16] has been to target structures that have led to the separation of value creation and profits within MNE groups, resulting in the diversion of profits to low-tax jurisdictions.[17]

BEPS Action 8 aims to develop rules that would prevent tax base erosion and profit shifting caused by, for example, intra-group transfers of intangibles. The 2017 OECD Guidelines have adopted a wide definition of intangibles, provide instructions on the allocation of profits related to the utilization of intangibles on the basis of value creation and contain transfer pricing rules for hard-to-value intangibles.[18] The aim of the OECD's BEPS Project was to target principal and holding company structures with no or only thin substance, i.e. structures where the principal or holding companies had no or only a few employees or no or only limited business activities. The aim of the 2017 OECD Guidelines is to ensure that profits will, to a greater extent, accrue in the location where the people generating the profit are located.[19]

In light of the 2017 OECD Guidelines, the concept of economic, as well as legal, owner is relevant. The economic owner of intangibles is the controlled company that has contributed to the creation of the intangible by, for example, assuming risks. According to the "substance requirement", holding an asset, without performing the related function(s), does not entitle the entity to returns generated by the intangible. Providing funding for the development of intangibles does not entitle one to the returns generated by the intangible itself, but rather to a return on funding.[20] Despite the division between legal and economic ownership, legal ownership has remained the starting point for an arm's length analysis and the legal owner is considered to be the owner of the intangible for transfer pricing purposes. While determining legal ownership is an important first step in an arm's length analysis, this question is separate and distinct from the question of remuneration under the arm's length principle, i.e. each party's entitlement to the income generated by the intangible.[21]

15. *See* C. Bellingham & J. Lindstrom, *Sustainability – Why the tax authorities care*, in *Sustainability and defense of principal company structures*, Intl. Tax Rev. (17 Feb. 2012).
16. *2017 OECD Guidelines*.
17. *See*, for example, OECD, *Aligning Transfer Pricing Outcomes with Value Creation – Actions 8-10: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD 2015), 3 and 9-12, International Organizations' Documentation IBFD.
18. Id., 63. Prior to the BEPS Project, the OECD discussed principal company structures in Chapter IX of the Guidelines (Business Restructurings). The guidance in Chapter IX addresses implementation and changes in the MNE group's business model and determining an arm's length compensation for the transfer of intangibles and the restructuring itself, whereas the *2017 OECD Guidelines*, *supra* n. 9, Chapter VI, concentrate more on the allocation of profits between the related parties during the lifespan of the model.
19. *See also* Raunio, *supra* n. 5, at 114.
20. *See*, for example, *2017 OECD Guidelines*, *supra* n. 9, at paras. 6.54 and 6.55.
21. *Supra* n. 17, at 64 and *2017 OECD Guidelines*, *supra* n. 9, at paras. 6.40 and 6.42-6.43.

Thus, it is important to consider whether or not implementation of the IP principal or IP holding company structure has led, or will lead to, changes in business activities, how risks are assumed and controlled, as well as decision-making related to the value creation. If the IP principal or IP holding company does not have any real-life business-related substance, the IP principal or IP holding company's entitlement to accrued profits in respect of the intangibles can be questioned.[22] It is, therefore, important to make a distinction between IP business principal companies and mere IP holding companies with little or no substance.

The arm's length principle requires that both compensation for an intra-group transfer of an intangible, as well as compensation from intra-group exploitation of the intangible, is assessed at the level of individual companies.[23] Transfer of legal ownership[24] of the intangible does not necessarily lead to changes in entitlement in respect of profits generated by the intangible between the related parties.[25] In making such an assessment, it is important to take into account whether a transfer of legal ownership is for administrative simplicity only or whether the restructuring has affected the parties performing or controlling functions related to DEMPE[26] or other important functions described in section 3.2.[27]

Sections 3.2. to 3.4. present three simplified examples of principal and holding company structures and their analysis under the 2017 OECD Guidelines: a business principal (IP principal), an IP holding company with some functions and staff and a mere IP holding company with no staff and functions.

3.2. Business principal of intangibles (IP principal)

The rationale of the principal model can be simplified as follows. The principal company is an entity belonging to an MNE group that assumes the entrepreneurial risks related to an identified part of the MNE group's business in an identified geographical market area.[28] Other affiliates of the MNE group that are conducting business activities in the same market area perform "routine activities", such as manufacturing, assume routine risks and utilize routine assets. The local affiliates assume only the risks that are related to their own business activities. The principal company guarantees the routine profit to the local manufacturing and distribution affiliates in the event they perform in accordance with intra-group agreements. If the business is profitable and the principal company

22. *See* Bellingham & Lindstrom, *The defence strategy*, in Bellingham & Linddstrom, *supra* n. 15.
23. *See 2017 OECD Guidelines*, *supra* n. 9, at para 9.9 and, for example, para 9.60 and Jaakkola et al. *supra* n. 9, at 240.
24. The concept of "legal ownership" is not suited to, for example, patents. However, the authors use the concept due to its clear meaning.
25. *See 2017 OECD Guidelines*, *supra* n. 9, at para 9.57.
26. Development, Enhancement, Maintenance, Protection and Exploitation. The concept of DEMPE functions was introduced into the *2017 OECD Guidelines*, *supra* n. 9. The concept is relevant in determining the MNE group companies' entitlement to profits generated by the intangibles.
27. *See 2017 OECD Guidelines*, *supra* n. 9, at para 9.58.
28. These include risks related to funding, business activities and operative activities that arise from ownership of an asset or providing services.

has managed to make accurate projections, the principal company will end up showing its profit as residual profit, i.e. profit exceeding the routine profit of the intangible. The principal company is, however, required to compensate the manufacturing and distribution affiliates even if the business is not profitable. As a result, the principal company may end up showing a loss.[29] The principal company is the party that assumes and controls the entrepreneurial risks, as well as related operational decisions. Residual profit, therefore, accrues in respect of the principal's non-routine functions, risks and intangibles.

The people that are key decision-makers in the value chain of the business are employed by the principal company.[30] The local companies own only "routine intangibles", whereas the unique and valuable intangibles are centralized in the principal company. A full-scale IP principal business assumes full entrepreneurial risks regarding the business and owns the unique and valuable intangibles needed in its business activities. All value-adding functions and entrepreneurial risks related to the intangibles are centralized within the principal company, whereas all routine functions, such as routine manufacturing and distribution functions, routine risks, as well as routine intangibles and other assets, remain with the local affiliates. Therefore, the IP principal is entitled to all profits generated by the intangibles. The local companies are entitled to "routine profit".

In the transfer pricing praxis preceding the BEPS amendments, profits exceeding routine profits were typically allocated to intangibles, i.e. to the IP principal or IP holding company owning the intangibles. In light of the 2017 OECD Guidelines, such profit is generally allocated to functions. Those functions include, in particular, functions related to risk assumption and control related to the creation and maintenance of intangibles. As a result, entitlement to profits generated by intangibles is based on functions actually performed and risks actually assumed by the parties. These amendments may also be applied to structures implemented prior to the BEPS amendments.

Thus, what needs to be addressed is when the IP principal can be regarded as a business principal that has assumed all the risks and is entitled to all profits that accrue in relation to intangibles.[31] This topic is now discussed in Chapter VI of the 2017 OECD Guidelines in more detail.[32] The starting point for the analysis is to identify legal ownership of the intangibles, the legal owner typically being the IP principal. The legal owner of the intangibles is entitled to all profits generated by the intangibles if the IP principal, in substance":

- performs and controls all the functions (including the "important functions")[33] related to the development, enhancement, maintenance, protection and exploitation of the intangible;
- provides all assets, including funding, necessary to the development, enhancement, maintenance, protection and exploitation of the intangibles; and
- assumes all risks related to the development, enhancement, maintenance, protection and exploitation of the intangible.[34]

According to the OECD, in analysing the arm's length nature of transfers or utilization of intangibles and in performing the functional and comparability analysis, it is important to pay attention to the identification of intangibles and associated risks, their legal ownership and other contractual terms, the DEMPE functions performed by other affiliates of the MNE group, controlled transactions involving intangibles and the role of the transactions in the value chain of the intangibles.[35]

The guidance on risks can be found in Chapter I of the 2017 OECD Guidelines, in which the assumption of risks is identified through the concept of *control*. The functions needed to control the risk and their extent are linked to the risks of the transaction in question.[36] A member of the MNE group has control over risk if it has (i) the capability to make decisions to take on, lay off, or decline a risk-bearing opportunity and (ii) the capability to make decisions on whether and how to respond to the risks associated with the opportunity.[37] In addition, the 2017 OECD Guidelines require actual performance of these decision-making functions.[38] The risk is allocated to the party that is able to control the risk and has the financial capacity to assume the risk. Financial capacity to assume the risk means that the party assuming the risk has access to funding to take on or lay off the risk, to pay for risk mitigation functions and to bear the consequences of the risk in the event the risk materializes.[39]

The principal company is able to perform the decision-making functions related to a particular risk if the persons employed by the principal have enough competence and experience to make the relevant decisions and to understand the consequences of those decisions. Mere formalization of the outcome of decision-making in the form of, for example, meetings, minutes of meetings and the signing of related documents do not qualify as enough of an exercise of a decision-making function to demonstrate control over a risk.[40]

29. *See* Bellingham & Lindstrom, *supra* n. 15 and S. Banker, "Principal Structure: Centralizing Regionally" in *The Tax Efficient Supply Chain*, 13 Supply Chain Management Rev. 2 (Mar. 2009).
30. *See*, for example, Banker, id.
31. It should be noted that entitlement to the profit generated by the intangibles refers to entitlement on a general level, i.e. it does not necessarily mean that taxable, factual profit has been generated.
32. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 6.32 et seq.
33. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 6.56. These activities include functions such as the decision-making related to the protection and defense of intangibles and quality control of functions performed by other parties. In addition, such important functions include strategic decisions on research and marketing, blue-sky research and development programmes of self-developed intangibles and the management and control of budgets.
34. *2017 OECD Guidelines*, *supra* n. 9, at para. 6.71.
35. Id., at para. 6.4 et seq.
36. Id., at para. 6.63 and paras. 1.65-1.66.
37. Id., at para. 1.65. *See also* para. 1.61.
38. Id., at paras. 1.65 and 1.93.
39. Id., at para. 1.64.
40. Id., at para. 1.66.

To the extent that members of the MNE group other than the IP principal perform functions, use assets, or assume risks related to the DEMPE functions related to the intangible, these other members must be compensated on an arm's length basis for their contributions. This compensation may even constitute all or a substantial part of the return derived from the exploitation of those intangibles.[41]

3.3. IP holding company with some own business activities and substance

In the past, in particular, mere formal matters, such as registration of the holding company under the laws of the location jurisdiction, have been enough for the IP holding company to be entitled to local tax benefits. Nowadays, it is more common for the location jurisdiction to also require the company to perform, at least to some extent, business activities, i.e. to have actual substance in that jurisdiction. In such a scenario, the IP holding company has legal ownership of the intangibles, performs at least some functions related to the administration of the intangibles and has some personnel in charge of such functions.[42] Such an IP holding company does not generally further develop the intangibles it legally owns. Instead, the IP holding company licenses the intangibles to the other members of the MNE group or, exceptionally, also to third parties.[43] The IP holding company's personnel does not perform DEMPE or other important functions. An arm's length compensation for this kind of IP holding company needs to reflect the limited functions it actually performs.

An IP holding company usually has some personnel that takes care of measures related to the licensing and the protection of intangibles, or at least the outsourcing of such functions. The holding company does not typically employ research staff or management, but persons that concentrate on legal and administrative activities.[44] The tax authorities may regard these types of functions as formal or minor in nature and, in any event, not as functions that would entitle the entity to the profit generated by the intangibles. This type of holding company can be seen as entitled merely to arm's length compensation for the services it provides.[45] These types of IP holding company structures gained the attention of tax authorities even prior to the publication of the BEPS Final Reports and revisions to the OECD Guidelines. The revised OECD Guidelines have further strengthened the tax authorities' possibilities to challenge such structures. An IP holding company might be regarded as merely providing services related to the administration of the intangibles, leading only to entitlement to arm's length compensation for such services.[46]

3.4. Mere or simple IP holding company

In its simplest form, an IP holding company is a company typically established in a low-tax jurisdiction and/or a jurisdiction offering special tax benefits only for the purposes of enjoying a low-tax rate or special tax benefits. The intangibles of the operative group companies are transferred to the IP holding company. The IP holding company licenses back the intangibles to the operative companies so that the operative companies are able to continue exploiting the intangibles. The IP holding company is the legal owner of the intangibles and receives royalties from the operative companies. The IP holding company does not carry out other activities, such as manufacturing or sales activities.[47] In addition, the company does not employ personnel, but, instead, other members of the MNE group perform functions related to the maintenance of the intangibles.

A mere IP holding company only has legal ownership of the intangibles transferred to it as a result of contractual arrangements. The implementation of the model does not lead to changes in the business activities related to the intangibles, other than merely formal or minimal ones. Instead, the structure leads to a transfer of profits to a low-tax jurisdiction.[48] Mere holding companies have been utilized in jurisdictions that require nothing more than mere formal substance from companies to enjoy tax benefits aimed at IP holding companies.

According to the 2017 OECD Guidelines, a mere IP holding company is not entitled to the profits generated by the intangibles. According to the Guidelines it is clear that, for example, assuming the expenses related to the intangibles does not lead to entitlement to the respective profits and is not enough for the holding company to be considered to be the business principal in the event the IP holding company does not actually perform functions, including the assumption of the risks related to the intangibles. Carrying the expenses related to the intangibles would entitle the party in question to compensation for the funding it provides if it also assumes the risks related to funding.[49] This represents as a clear difference from previous transfer pricing praxis and the interpretation of the OECD Guidelines, in respect of which a mere contractual assumption of expenses has been seen to be equal to performing the related functions, entitling the entity to the profits generated by the intangibles.

41. Id., at paras. 6.71 and 6.72.
42. The prerequisites for enjoying local tax benefits offered to intangible business principal and holding companies regarding, for example, the nature of the activities and the substance may also become stricter in the future due to BEPS Action 5. The Action recommends that tax benefits be granted only in the event the principal company actually carries out the business the principal company's profits are related to (*see* P.R. West & A. Varma, *The OECD's BEPS Final Report. Part IV: Tax Planning*, Tax Executive 32 (Nov./Dec. 2015).
43. *See*, for example, Quiquerez, *supra* n. 4, at 304.
44. Id., at 315.
45. *See* Bellingham & Lindstrom, *supra* n. 15.
46. *See supra* n. 17, at Annex to Chapter VI, Example 1 and M. Levac, *Revisions to the guidance on intangibles*, International Transfer Pricing Seminar, Helsinki 2015.
47. Quiquerez, *supra* n. 4, at 309-310.
48. *See* Bellingham & Lindstrom, *supra* n. 15.
49. *See 2017 OECD Guidelines*, *supra* n. 9, at para 6.59.

4. Analysis of the Arm's Length Nature of Centralization of Intangibles

4.1. Transfers of individual intangibles

Apart from the establishment of a principal or IP holding company structure, related parties may also transfer individual intangibles between the MNE group companies. Identification and valuation problems arise in both situations, i.e. transfers of individual intangibles and business restructurings involving intangibles. Identification can be difficult because intangibles are not always protected, registered or visible on the transferor's balance sheet. Valuation issues refer to the complexity and uncertainties of valuating intangibles.[50] Intangibles are often the most important assets of the MNE group, typically being unique at least to some point. Therefore, analysing the arm's length nature of the transfers is challenging. It may be particularly difficult to forecast the value of intangibles at the moment of transfer. Intangibles may prove to be profitable or totally worthless during the years following the transfer. In addition, transfers of intangibles can be difficult to identify.[51] In situations in which the intangibles require further development, uncertainties related to their value and profit potential can be significant.[52]

To avoid the aforementioned problems, MNE groups were previously recommended to carry out the development of new intangibles in the IP principal company and to transfer and register the most significant intangibles under the IP principal at an early stage of development. Instead, expiring patents were not transferred. If such patents were developed further, the development work was transferred to the IP principal. New patents that originated from such development work belonged, as a rule, to the IP principal.[53] After the BEPS amendments, such a solution might be risky. Under the 2017 OECD Guidelines, the related parties are required to address the use of mechanisms used by independent parties (for example, price adjustment clauses) in situations in which the valuation of the intangible is uncertain at the time of the transfer.[54] In addition, part D.4 of Chapter VI of the OECD Guidelines includes guidance on "hard-to-value" intangibles, which include intangibles that are not yet fully developed. The OECD's guidance is subject to interpretation, which is why transfers of intangibles other than established intangibles that are at the end of their exploitation period, but not being used as a platform for future development, may be risky and lead to double taxation.

In practice, intangibles can be transferred to the IP principal or IP holding company in three alternative ways. The first option is to *sell* (assign) the intangibles. In a sales transaction, legal ownership of the intangibles is transferred to the principal or IP holding company. This alternative is usually feasible if the intangibles to be transferred are not regarded as having a major profit potential.[55] A sales transaction is an agreement pursuant to which the seller assigns legal ownership of an object or asset to the purchaser for monetary consideration. The seller's obligation is to assign the object of the sale to the purchaser, whereas the purchaser's obligation is to pay the sales price to the seller.[56] An assignment of intangibles, such as an assignment of patents, means that the risks and rights related to the patent are, once and for all, transferred to the principal or IP holding company at the moment of the assignment.[57] The generally fixed sales price is paid in one or more instalments. The assignment agreement may include a mechanism under which the price can be adjusted based on, for example, a more precise valuation available in the future.

The second option is to grant a right to exploit the intangible commercially, i.e. to *license* the intangible, to the IP principal or IP holding company. In such a scenario, the licensor remains the legal owner of the intangible.[58] Licensing is a very common means of utilizing the intangible. By granting a licence, the licensor grants the right to exploit the invention to the licensee. The licence can be exclusive or non-exclusive (also known as a simple or parallel license). An exclusive licence also excludes the licensor's rights, whereas a parallel license provides the right to exploit, but not an exclusive right. Even an exclusive licence can be limited in several ways, such as by geographical area, manner of exploitation or time.[59] The licensor receives royalty payments that are based, for example, on the scale of usage of the intangible.[60] Generally, licences must be exclusive so that the licensed intangible can be protected and defended in a feasible way.[61] Licensing is a particular type of legal transaction pursuant to which certain essential rights and risks related to, for example, the registration and administration of the patent remain with the licensor, whereas under an assignment transaction, such rights and risks are transferred to the purchaser.

In practice, licensing is much more common than an assignment of intangibles. Under a licensing transaction, the consideration for the grant, such as a royalty payment, is usually based on the commercial value of the intangible, i.e. the profit generated from the exploitation of the intangible. In an assignment transaction, the consideration is typically a lump-sum payment defined prior to the assignment. As assignments are associated with major risks, they are generally not the preferred alternative.[62] Licence agree-

50. Id., at para 9.55 and Jaakkola et al. *supra* n. 9, at 239.
51. *See* Bakker, *supra* n. 7, at 37-38.
52. Id., at 38-39. In the United States, the future development in terms of the value of the intangible can be taken into account in later years and the valuation can be reassessed accordingly based on hindsight (*commensurate-with-income standard*).
53. *See* Frick & Kronauer, *supra* n. 9, at 36.
54. *See*, in particular, *2017 OECD Guidelines*, *supra* n. 9, at paras. 6.182 and 6.183.
55. *See* Bakker, *supra* n. 7, at 38-39.
56. M. Hemmo & K. Hoppu, *Sopimusoikeus*, Jatkuvatäydenteinen sec. 11 (AlmaTalent Fokus 2017).
57. *See*, for further details on the assignment of a patent, P.L. Haarmann, *Immateriaalioikeus, uudistettu painos* 229 (5th ed., Talentum 2014).
58. *See* Bakker, *supra* n. 7, at 39.
59. Haarmann, *supra* n. 57, at 229.
60. *See* Bakker, *supra* n. 7, at 39.
61. *See* Valoir, *supra* n. 13, at 20.
62. Such risks are related, for example, to the risk that the purchaser assumes in the event the valuation of the intangible is highly uncertain at the time of the assignment. The risk position of the licensee is clearly differ-

ments take into account both parties' interests in a more equitable manner.[63] Licence agreements may also include mechanisms by which the amount of royalty payments can be adjusted in the event the commercial value of the intangible changes.

The third option is to share the costs and risks related to the development of an intangible by entering into a cost contribution arrangement (CCA). Under such an arrangement, the parties that participate in the development of an intangible will receive an exclusive right to exploit the intangible in their relevant geographical area.[64] When entering into an existing CCA, the principal or IP holding company makes a *buy-in* payment to the legal owner of the intangible. Thereafter, the parties conclude an agreement on sharing the costs.[65] As the principal or IP holding company gets the right to exploit the developed intangible in its own geographical area, it is not obliged to pay royalties to the legal owner of the intangible. Instead, the principal or IP holding company gets royalty payments from the operative companies that exploit the intangible under its (joint) legal ownership.[66] A CCA may also lead to joint legal ownership of the intangible between the parties. Acceptance of the CCA, from a transfer pricing perspective, requires that every participant of the arrangement benefit from the arrangement.[67] If this is not the case, the party not benefiting from the arrangement can be regarded as a mere service provider. An arm's length analysis of CCAs is not conducted on a transaction-by-transaction basis, although the arrangement should, as a whole, lead to an arm's length outcome.[68]

Each of these alternatives has a different legal form. Whereas sales/assignments and licences involve a single legal transaction, a CCA consists of several, legally separate transactions. The arm's length analysis of the alternative chosen by the parties must be based on its legal character. Whether the taxpayer has characterized the controlled transactions as an assignment of patent rights or as a perpetual exclusive licence for its remaining useful life does not affect the determination of the arm's length price.[69] This means that the transaction chosen and implemented by the parties must be accepted, but its pricing must lead to an arm's length result. The related, as well as unrelated, parties are able to choose the means to execute the transfer. The transferor may retain all rights to the intangible developed further by the licensee or the licensee may be entitled to all rights to the further developed intangible either until the end of the licensing period or for the entire useful life of the intangible. Such limitations can, naturally, affect the valuation of the transferred intangibles and their comparability in relation to other transactions. The form of legal transaction is, however, at the discretion of the parties.[70] The arm's length principle only requires that compensation, whether a lump-sum payment under an assignment agreement or royalty payments under a licence agreement, be arm's length.

Under the 2017 OECD Guidelines, the transaction chosen and implemented by the related parties is the starting point of the arm's length analysis. The consideration can be paid as a lump-sum payment or over a longer period. Both models are used by third parties. The OECD Guidelines do not oblige the tax authorities, for example, to replace ongoing royalties with a lump-sum royalty payment if both lead to an arm's length *result*, or even justify such an action.[71] It is, therefore, essential to identify the transaction chosen and implemented by the parties. Usually the transaction is easily identified based on the agreement between the related parties.

4.2. Business restructurings and transfers of an ongoing concern

Implementation of an IP principal or IP holding company model pursuant to a business restructuring is discussed in Chapter IX of the 2017 OECD Guidelines. Centralization of intangibles is a typical form of business restructuring. Chapter IX was already included in the 2010 OECD Guidelines and did not undergo substantial amendments in the 2017 version.

Business restructuring is not a separate type of legal transaction. Instead, it usually consists of multiple transactions.[72] For example, when an intangible is transferred and the transferor continues to exploit the intangible in its own business activities, unrelated parties would also agree on the terms of the future exploitation of the intangible by, for example, concluding a licence agreement. Therefore, an arm's length analysis of the restructuring includes (i) the arm's length nature of the compensation for the transfer itself; (ii) the arm's length nature of compensation from the exploitation (licence) of the intangible, i.e. royalties; and (iii) an analysis of the amount of profit generated from the exploitation of the intangible and its effect on the arm's length assessment of (i) and (ii).[73] The arm's length analysis must be based on the transactions actually carried out between the related parties and the assessment cannot ignore, for example, transfers of functions to another group company.[74] The same assessment applies to terminations, renegotiations and transfers of agreements. In such scenarios, it is important to identify whether a valuable contractual right (which also constitutes an intangible in itself) has been transferred

ent, as the licensee does not assume the risk related to the future value of the intangible.

63. Haarmann, *supra* n. 57, at 231.
64. *See* Bakker, *supra* n. 7, at 39 and *also* Quiquerez, *supra* n. 4, at 309-311.
65. When a new CCA is established with the legal owner of the intangibles, the principal or IP holding company makes a "balancing payment". *See 2017 OECD Guidelines*, *supra* n. 9, at Chap. VII, part C.5.
66. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 8.44 and C. Fuest, C. Spengel, K. Finke & H. Nusser, *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform*, Discussion Paper No. 13-078, Zentrum für Europäische Wirthschaftsforschung GmbH, 5-6 (Oct. 2013).
67. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 8.13.
68. *See* M. Helminen, *Kansainvälinen verotus: Jatkuvatäydenteinen* sec. 8. (AlmaTalent Fokus 2017).
69. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 6.89.
70. Id., at paras. 6.179 and 6.90.
71. Id., at para. 6.89.
72. Id., at paras. 9.1 and 9.2, as well as 9.13 and 9.14.
73. Id., at para. 9.61.
74. Id., at para. 9.35.

and whether such a transfer would be compensated for in transactions between unrelated parties.[75]

In determining a possible arm's length compensation for the restructuring, it is important to understand the content of the restructuring, business purposes and benefits of the restructuring, as well as realistically available alternatives. Therefore, the functions, assets and risks of the parties, as well as their rights and obligations, must be analysed both before and after the restructuring.[76] Based on the views discussed in more detail in sections 3.1. and 3.2., a transfer can be regarded as a transfer of an ongoing concern related to intangibles only in situations in which the IP principal transfers, in addition to legal ownership of the intangibles, DEMPE functions and other important functions (in practice, the people performing these functions), risks assumed in relation to the intangibles, as well as related control.

A business restructuring does not, in itself, mean that, for example, a principal position or ongoing concern is transferred. If the centralization involves a transfer of an ongoing concern related to the intangibles, it is necessary to analyse whether the transfer of such an ongoing concern would involve compensation for the transferred goodwill in a transaction between unrelated parties.

The role of intangibles in business restructurings can be divided into four categories.

(1) only one or some individual intangibles are transferred;
(2) the whole business related to the intangibles is transferred;
(3) a constituent function, an ensemble of functions or several intangibles are transferred, but not an entire ongoing concern; and
(4) the existing contractual business model regarding the intangibles is abolished or renegotiated.[77]

Under the *first* category, transfer pricing issues relate to the assessment and valuation of individual assets, typically the arm's length nature of royalty payments. The intangibles are valuated separately and no goodwill needs to be considered. Occasionally, the transferor may continue to exploit the intangibles in its business activities after the transfer.[78] Under the *first* category, the analysis under the arm's length principle is based on the principles described in section 4.1. Under the *second* category, the goodwill must be considered in valuing the transferred ongoing concern, whereas goodwill should not, at least automatically, be considered under categories 3 and 4.[79] For the purposes of this article, the *second* category is the most interesting. Under the *second* category, the business related to the intangibles is transferred to another MNE group member. In such situations, the arm's length value in respect of the transfer of the ongoing concern of intangibles must be determined.

The mere fact that a member of the MNE group begins to perform functions that were previously performed by another member of the MNE group does not, as such, constitute a transfer of an ongoing concern.[80] It is, therefore, essential to identify whether the transfer actually involves a transfer of an ongoing concern. In situations in which only one or more individual intangibles are transferred or amendments to intra-group agreements are made, such transfers should be evaluated as separate transactions under the arm's length principle. The arm's length principle does not require that mere amendments in terms of profit potential are compensated, as such amendments would only involve replacing a higher amount of higher-risk profit with a lower but more stable amount of profit.[81] For example, under the *fourth* category, the arm's length analysis may involve the assessment of the termination period or termination payment. This is so especially in situations in which a member of the MNE group has made a significant investment based on the renegotiated agreements. In any event, no ongoing concern is transferred and the arm's length analysis is limited to the arm's length nature of the agreement terms.

In the 2017 OECD Guidelines, the transfer of an ongoing concern is defined as a transfer of a functioning, economically integrated business unit. The transfer of an ongoing concern means a transfer of assets, bundled with the ability to perform certain functions and assume certain risks. For example, when a business restructuring involves a transfer of a business unit that includes, among other things, research facilities with an experienced research staff, the valuation of such an ongoing concern should reflect, among other things, the value of the facility and the impact of the assembled workforce on the arm's length price.[82] A transfer of an intangibles business can be regarded as a transfer of an ongoing concern merely if the aforementioned transferred research team has performed the DEMPE and other important functions related to the intangibles and has assumed and controlled the related risks. For example, a mere IP holding company described in section 3.4. that has only acted as a contract-based "principal" without performing any functions, cannot transfer an intangibles business, as the company has not been carrying on an ongoing concern.

In analysing the arm's length nature of business restructurings and transfers of ongoing concerns, it is crucial to recognize what has been transferred by the related parties and, even more so, what the related parties have been able to transfer. In an arm's length assessment, the priority must be to identify all intangibles and controlled transactions as separate items and to determine their arm's length value accordingly. Assessing a business restructuring as a transfer of an ongoing concern is possible merely in sit-

75. Id., at para. 9.67 and paras. 9.75-9.78.
76. M. Raunio & E. Gerdt, *Liiketoimintamallin uudelleenjärjestely siirtohinnoittelun näkökulmasta*, Verotus 3, 263 (2009).
77. *See* H.-K. Kroppen & J.C. Silva, *General Report*, in *Cross-Border Business Restructurings 42-42* (IFA Cahiers vol. 96A, IBFD 2011), Online Books IBFD. *See also* R. Knuutinen, *Liiketoiminnan kansainväliset uudelleenjärjestelyt, aineeton omaisuus ja verotus: Transaktion tunnistamista vai uudelleenluonnehdintaa?*, Defensor Legis 6, 1067 (2015).
78. *See* Jaakkola et al. *supra* n. 9, at 239.
79. Knuutinen, *supra* n. 77.
80. Raunio & Gerdt, *supra* n. 76, at 271.
81. Kroppen & Silva, *supra* n. 77, at 19.
82. *2017 OECD Guidelines*, *supra* n. 9, at para. 9.68.

uations in which the business principal described under section 3.2. transfers the ongoing concern regarding the intangibles, i.e. where the transfer includes the persons that have carried out the DEMPE and other important functions related to the intangibles business.[83]

Example 1

An IP holding company with no employees licenses an intangible exclusively to another group company. DEMPE and other important functions related to the intangible were being performed by the other MNE group companies. The company that has granted the licence has not transferred an ongoing concern or principal position, but, instead, a mere right to exploit the individual intangible.

Example 2

An MNE member company has performed routine R&D activities and provided R&D services to other group companies. The service agreement is terminated and the company stops performing the functions. In such a scenario, the question is whether the termination of the services agreement would have been compensated in a transaction between unrelated parties. If something of value, for example, an intangible, is transferred in connection with the termination or renegotiation of the agreement, the arm's length nature of the compensation for the transferred intangible must be assessed separately from compensation due to termination.[84] The transactions do not constitute a transfer of an ongoing concern.

5. Centralization of Intangibles and the Scope of Application of the Finnish Domestic Transfer Pricing Adjustment Provision

In Finland, controlled transactions related to IP principal and IP holding company models are assessed under section 31 of the Act on Assessment Procedure (1558/1995) (AAP), i.e. the Finnish transfer pricing adjustment provision. No published case law is available on the application of the said provision in respect of IP principal or IP holding company models or on the application of the 2017 OECD Guidelines. However, based on previous case law on the scope of application of the said provision, conclusions can be drawn on how IP principal and holding company models should be assessed under the Finnish transfer pricing provision.

The wording of section 31.1 of the AAP is as follows:[85]

> If the business transaction between a taxpayer and an associated party has been carried out pursuant to agreed or imposed conditions that differ from what would have been agreed on between unrelated parties, and the taxable income of the taxpayer's business or other operations has thus decreased or the loss increased from what it would otherwise have been, the income is increased by an amount corresponding to what would have accrued had the conditions corresponded to those that would have been agreed on between unrelated parties.

The wording of the Finnish transfer pricing adjustment provision has a wide scope. It corresponds, to a large extent, to the wording of article 9 of the OECD Model (2014).[86] Questions regarding how income generated by intangibles should be distributed between the related parties using IP principal or holding company structures or how centralization of the intangibles into an IP principle or IP holding company should be assessed under section 31 of the AAP cannot be answered based solely on the wording of the provision. Therefore, the OECD Guidelines are particularly relevant in interpreting the Finnish provision. The importance of the OECD Guidelines has also been recognized in the case law of the Finnish Supreme Administrative Court (SAC). The SAC, however, has taken the position, in its case law, that the OECD Guidelines also include guidance that is not within the scope of application of the domestic transfer pricing adjustment provision. The recommendations of the OECD Guidelines cannot allow the Finnish Tax Administration to exceed the scope of application of the provision.[87]

The most relevant precedent on the scope of application of the provision is the decision in KHO 2014:119 (3 July 2014).[88] In this decision, the SAC concluded that "re-characterisation"[89] of related-party transactions described in the 2010 OECD Guidelines[90] was outside the scope of application of the Finnish transfer pricing adjustment provision. The Supreme Administrative Court stated that transfer pricing adjustments can only cover an examination of the arm's length nature of "terms and conditions of the transaction as agreed and implemented by the parties", meaning that the arm's length assessment is limited to whether the amount of taxable income or deductible expenses is at arm's length. Based on this holding, the terms of the controlled transaction can be adjusted under the transfer pricing adjustment provision only to the extent that such adjustment does not alter the nature of the legal transaction.[91]

In a more recent decision, KHO 2017:145 (13 September 2017), [92] the SAC further clarified the scope of application of the transfer pricing adjustment provision. In this case, the SAC held that the SaaS model (Software as a Service, i.e. covering the costs of the Enterprise Resource Planning (ERP) system through service fees charged to other MNE group companies) agreed and implemented by the related parties could not be assessed under section 31 of the AAP as a CCA (i.e. a sharing of costs between the group companies as the costs are being incurred). The SAC held that the *business model* chosen and implemented by the related parties could not be regarded as deviating from what would have been agreed between unrelated parties. Based on this ruling, the business model chosen

83. Id., at para. 9.70
84. Id., at para. 9.77.
85. Unofficial translation from Finnish.
86. *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD.
87. *See also* M. Raunio & A. Isomaa-Myllymäki, *Two Recent Transfer Pricing Preliminary Rulings by the Finnish Supreme Administrative Court*, 25 Intl. Transfer Pricing J. 1 (2018), Journals IBFD.
88. FI: SAC, 3 July 2014, KHO 2014:119, Tax Treaty Case Law IBFD.
89. The *2017 OECD Guidelines*, *supra* n. 9, use the concept of non-recognition (paras. 1.122 and 9.35).
90. OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD 2010), para. 1.65, International Organizations' Documentation IBFD.
91. *See also* Raunio & Isomaa-Myllymäki, *supra* n. 87, at sec. 2.2.
92. FI: SAC, 13 Sept. 2017, KHO 2017:145. The holding was analysed in Raunio & Isomaa-Myllymäki, *supra* n. 87 and M. Urpilainen, *Kaksi siirtohinnoittelua koskevaa prejudikaattia – KHO 2017:145 ja KHO 2017:146*, Case Law Commentary (29 Sept. 2017), available at www.edilex.fi/18367.

and implemented by the related parties must be taken as the basis for an arm's length assessment. The assessment cannot be based on an alternative model that would, in the tax authorities' opinion, implement the arm's length principle in a more suitable manner. The transfer pricing adjustment provision's scope of application is limited to the assessment of the terms and conditions of the chosen and implemented transaction according to its form. Based on the above, if an adjustment to the terms of the controlled transaction were to lead to an outcome pursuant to which the allocation of risk between the related parties would also be altered, such an action may not fall within the scope of application of section 31 of the AAP. This is because the allocation of risk between parties is an essential element of the transaction. An adjustment to the risk allocation could easily transform the legal transaction that has been implemented and lead to non-recognition or recharacterization of the controlled transaction.[93] Non-recognition or recharacterization of controlled transactions requires that the prerequisites for applying the Finnish GAAR be met.

An assessment of the facts of the legal transaction, i.e. a controlled transaction under section 31 of AAP, and the delineation of the controlled transaction, should not be confused with an assessment of the arm's length nature of the transaction. The delineation of a controlled transaction, i.e. the determination of its existence, form and content must always be done prior to application of the arm's length principle.[94] The delineation cannot be based on the application of the arm's length principle.[95] Instead, it must be based on facts. If the facts correspond to the civil law form of the transaction chosen and implemented by the related parties, a deviation from this civil law form is possible only in the event such an action can be based on a provision other than the transfer pricing adjustment provision. If such a provision cannot be found, a deviation is only possible if the prerequisites for the application of the Finnish GAAR are met. The form of transaction also covers the business model agreed to and implemented between the related parties, i.e. the legal arrangement and risk allocation of the organization or transaction. An example of such risk allocation is an MNE group member's role as a full or limited risk manufacturer.

The transfer pricing model applied needs to be based on the chosen business model. Does section 31 of the AAP imply that, in respect of an arm's length assessment of the transfer pricing model chosen,[96] the tax authorities are entitled to consider that, for example, instead of ongoing royalty payments, under an arm's length pricing model, the recipient would have been entitled to a lump-sum payment? Caution must be exercised with regard to this approach. Such a transfer pricing adjustment would require evidence of the non-arm's length nature of the transfer pricing model, i.e. that unrelated parties would not have chosen such a model (ongoing royalty payments). Such evidence cannot be based on, for example, reference to the OECD Guidelines or legal literature supporting the proposition that a lump-sum payment is a common payment form. Instead, such a conclusion needs to be based on empirical evidence.[97] Such evidence is challenging to find, as unrelated parties may well use either lump-sum or ongoing royalty payment-based pricing. The starting point in the OECD Guidelines is that only the arm's length end result counts.[98] As both lump-sum payment and ongoing payments may lead to an arm's length result, the transfer pricing model chosen and implemented by the parties is the basis for assessment under section 31 of the AAP. It is important to note that in replacing ongoing royalties with a lump-sum payment the tax authorities may be led to disregard the business model implemented, as such an adjustment would change the risk allocation between the related parties in a substantial way. As stated in earlier in this section, this may mean non-recognition or recharacterization of controlled transactions, which is only allowed where the prerequisites for applying the Finnish GAAR are met.

In addition, it is important to note that both the OECD Guidelines, as well as Finnish domestic legislation, are based on the separate entity approach, meaning that an arm's length assessment must always be made from each MNE group member's perspective. In the OECD Guidelines, this assessment is based on the functions performed, assets used and risks actually assumed by each individual entity. From a domestic law perspective, the analysis is conducted based on the legal transactions concluded by the member of the MNE group. For example, a member of the MNE group can never transfer assets owned by other members of the MNE group or receive compensation based on such items under the arm's length principle.

Section 31 of the AAP, as well as other Finnish domestic provisions, are based on the taxation of legal transactions. Risks and functions, as described in the OECD Guidelines, are not legal transactions. Therefore, the transfer pricing adjustment under section 31 of the AAP cannot be based on such concepts. Instead, when section 31 is applied, a legal transaction, such as licensing, needs to be identified between the related parties. Taking into account the scope of application of the domestic transfer pricing

93. Under the SaaS model, the risk is borne by the service provider, whereas under a CCA, it is borne by all participants in the arrangement. Of course, it should be noted that a CCA is only a helpful concept used by the OECD Guidelines for practical reasons, but it is not a type of legal transaction or business model, as such. However, CCAs utilize their own typical risk division (Raunio & Isomaa-Myllymäki, *supra* n. 87).
94. J. Wittendorff, *OECD Misinterprets Controlled Transactions*, Tax Notes Intl., 462 (4 May 2015) and A. Isomaa-Myllymäki, *supra* n. 2, at 215.
95. Isomaa-Myllymäki, id., at 215-216.
96. For the purposes of this article, the transfer pricing model is defined as the payment method agreed between the parties, i.e. lump-sum payment, instalment payments or payments including adjustment mechanisms. The term "transfer pricing model" should not be confused with "transfer pricing method", such as setting the price based on third-party comparable transactions. The transfer pricing method is used to assess the arm's length nature of a transfer price. The transfer pricing method follows from the transfer pricing model implemented.
97. In decision KHO 2014:119 (3 July 2014) even the minority of the SAC stated that, in the case at hand, no comparable equity funding that would have been granted between third parties, according to which the arm's length adjustment should have been made, was presented by the tax authorities or the tax recipients. Mere doubt regarding the arm's length nature of the transaction or pricing model is clearly not sufficient. *See*, for example, Isomaa-Myllymäki, *supra* n. 2, at 94-95 and 353.
98. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 6.89.

provision, the OECD Guidelines do not allow for the taxation of transferred DEMPE functions unless such a transfer is based on a legal transaction concluded between the related parties. The link between the OECD Guidelines and section 31 of the AAP can be described based on the following example.

Example 3

Let us presume that the delineation of transactions, that is, the facts of the case, indicate that a Swiss IP holding company of an MNE group has not, despite having legal ownership of the intangibles, performed any DEMPE or other important functions related to the intangibles, that the IP holding company does not control the risks related to the intangibles and that the IP holding company does not have the financial capacity to assume the relevant risks. Instead, the facts indicate that the functions and risks related to the intangibles remain with the Finnish MNE group company that originally transferred the intangibles to the Swiss IP holding company. The Swiss IP holding company has merely provided services regarding the administration of the intangibles. In light of the 2017 OECD Guidelines, the Swiss company should only be entitled to an arm's length compensation for the administrative services and the profit generated by the intangibles should be taxed as the Finnish MNE member company's income.[99] This kind of assessment cannot be made under section 31 of the AAP based on, for example, "delineation" of a fictitious transaction between the Swiss and Finnish group members based on which the residual profit could be transferred to the Finnish company. Neither can it be based on non-recognition of the transfer of the intangibles to the Swiss holding company unless the prerequisites for applying the Finnish GAAR are met. Instead, the application of section 31 of the AAP allows for the assessment of the transactions chosen and implemented by the parties, i.e. whether the Finnish company has received an arm's length compensation from the Swiss IP holding company for the services it has provided (for example, DEMPE functions and control of risks) in relation to the intangibles. The profit received by the Swiss IP holding company is not added to the Finnish company's income but, instead, the arm's length compensation from the services performed by the Finnish company that has not been paid is added to the Finnish entity's income. Similarly, based on section 31 of the AAP, it is not possible to "delineate" a fictitious transaction where the Swiss IP holding company has, instead of acquiring the intangibles, provided administrative services to the Finnish company. The transfer pricing adjustment provision only allows for the adjustment of the terms of the transaction, such as price, but not the replacement of an assignment with another legal transaction.

In situations in which the intangibles have been assigned between the related parties, the arm's length principle allows for an assessment of the sales price and the adjustment mechanism, if any. An arm's length assessment of intra-group licensing transactions is similarly limited to the terms of the license agreement, typically the arm's length nature of royalty payments. In these instances, the assessment is made on a transaction-by-transaction basis, i.e. by examining individual legal transactions. In situations in which CCAs are used between related parties, the legal transactions covered by the arrangement and the arrangement's arm's length nature are assessed.

If the related parties have licensed the intangibles, the assessment of the transaction's arm's length nature cannot be based on an alternative, fictitious transaction, such as an assignment. This is so even though the license would be perpetual and exclusive. In such a scenario, the legal transaction would be transformed into another form of legal transaction and the adjustment would fall outside the scope of application of section 31 of the AAP. If, instead, something else of value (in addition to the exploitation right under the licence agreement) is identified as being transferred between the related parties, the determination of an arm's length compensation upon such a transfer needs to be assessed as a separate transaction and not by bundling the transactions as in the case of, for example, a transfer of an ongoing concern. A transaction-by-transaction assessment must always be preferred.[100] The starting point of section 31 of the AAP, as well as other domestic Finnish provisions – excluding the GAAR – is always the taxation of the transaction chosen and implemented by the parties.[101]

6. Concluding Remarks

The BEPS amendments may require MNE groups to reconsider the principal and holding company models that are currently in use. In making such an assessment, it is important to understand the MNE group's business and to recognize critical functions, risks and their role in the group's value chain. The updated OECD Guidelines will move the focus from mere pricing adjustments to a wider assessment of controlled transactions. This shift may lead to divergent views on the relevant facts, their interpretation and the interpretation of domestic legislation and the OECD Guidelines between taxpayers and the tax authorities. In Finland, the scope of application of the domestic transfer pricing adjustment provision, as defined in the SAC's preliminary rulings in KHO 2014:119 and 2017:145, is decisive.

The 2017 OECD Guidelines are already in force. In this context, changes in the principal and holding company models require attention from both a business and tax perspective, as well as an analysis of the "critical functions" that the principal company needs to perform to be considered a principal.[102] Through such an analysis and careful documentation, structures backed by solid business reasons can still be utilized.

99. *See*, on the application to intra-group financing, Isomaa-Myllymäki, *supra* n. 2, at 126-127.

100. *See 2017 OECD Guidelines*, *supra* n. 9, at para. 3.9. An exception to this starting point are CCAs.

101. *See also* S. Penttilä, *Siirtohinnoittelua koskevat oikeuskäytännön linjaukset*, 119 (Vero-opintopäivät 2014).

102. *See* C. Bellingham & D. Zirakzadeh, *Principal Company Structure: Ensuring value from your Principal Company Structure*, Intl. Tax Rev. sec. 3 (12 Mar. 2013).