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MEMORANDUM

A / To :	Jeffrey Owens, Director, Centre for Tax Policy and Administration, OECD
De / From :	Anne Quenedey, Partner, Bird & Bird AARPI
Objet / Re :	Comments on the Transfer Pricing Aspects of Intangibles Invitation for comments dated July 2, 2010
Date :	September 14, 2010

More and more transactions involve intangible rights. Commercial relationships between related and unrelated parties include an increasing quantity of intangible rights. Several reasons are commonly underlined:

- development of new technologies and new services;
- global economy development;
- split of production of products and services between several countries is an increasing phenomenon.

Besides, we are less used to evaluating transfer prices of intangibles and have fewer references in that area. This increasing need is quite new and the dematerialised aspects of the intangibles give more room to numerous different approaches. Moreover, data available are often too basic compared to the complexity of the problematic related to intangibles.

It is therefore essential that the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (TPG) have a special focus on transfer pricing of intangibles.

We believe that putting in the agenda the potential revision of Chapters VI and VIII of the TPG is a responsible approach.

1. MOST SIGNIFICANT ISSUES ENCOUNTERED IN PRACTICE IN RELATION TO THE TRANSFER PRICING ASPECTS OF INTANGIBLES

There are “classic” practical issues relating to transfer pricing policy for intangibles (difficulty to apply TPG to an increasing number of intangible rights in a new complex and globalised environment).

OECD guidelines propose a wide definition of intangibles including rights to use industrial assets such as patents, trademarks, trade names, designs or models, as well as copyrights of literary, artistic or scientific work (including software) and intellectual property such as know-how and trade secrets. Customer lists, distribution channels, unique names, symbols or pictures may also be concerned.

There is however no practical criteria which are defined in order to identify the intangibles. The identification of intangibles may then be difficult in particular for intangibles which are

not legally protected and/or registered in the account. In practice, shall we consider that there is an intangible asset for tax purposes each time that a value source has been identified?

The identification is particularly complex concerning the contractual rights. When should such rights be considered as intangible assets? Which specific identification criteria should apply? At that stage, the lack of specific criteria entails only subjective appreciations which may be challenged by tax authorities.

As a consequence of this issue, the identification of the intangibles owner may also be complex and uncertain, particularly when intangibles have been developed within a multinational group by several enterprises. In such a case, application of transfer pricing principles is even more difficult and subjective.

Furthermore, OECD provides specific guidelines for determining the arm's length price of intangibles:

- use of comparables, taking into account all specific conditions of the controlled transactions, with adjustments;

- reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in the pricing of the transaction.

From a practical standpoint, these principles are difficult to apply due to the lack of practical information on:

- what should be the scope and the determination method of the adjustments;

- how to determine what would have been made by non related enterprises in such circumstances.

Some particularly difficult practical issues are:

- It is not sure that all intangibles should fall within the scope of taxation. Among the mass of the relationship and phenomena that could be qualified as intangibles, which one should be subject to transfer pricing rules?

- Some intangibles are identified at group level. However, it is difficult to split their taxable basis between the different jurisdictions that can claim part of the taxable basis. This difficulty comes either from a factual situation (the intangibles are co-developed and co-owned), or from the lack of comparable unrelated situations. Both cases should be analysed distinctly.

- There are situations in which some parties are the owner of part of an intangible right, for legal reasons or economic reasons, even if they are not the "entitled" owner of the rights. As a consequence, it is not certain that they may pay for the use of this right. This situation is commonly met with commercial assets when a party has participated to the development of a brand, directly or indirectly, and another party gives to that company a trademark licence.

2. SHORTFALLS IDENTIFIED IN THE EXISTING OECD GUIDANCE

With respect to the practical issues as identified above, we think that Chapters VI and VIII of the TPG could be valuably improved and detailed in the following areas:

- Determination of practical criteria to be fulfilled in order to identify intangibles;
- Determination of the specific intangibles directly concerned by the TPG;
- Addition of practical information relating to the determination of an arm's length consideration (including when valuation is highly uncertain at the time of the transaction);
- Addition of practical information relating to the allocation of the value between the different taxable bases when it is split between different countries.

3. AREAS IN WHICH THE OECD COULD USEFULLY DO FURTHER WORK

Identification of intangibles

First of all, it would be relevant to have an open discussion will all interested parties (lawyers, economists, financial actors) in order to collect their points of view and approaches on the intangibles definition, identification and valuation.

The second step would be to compare the different approaches of the transfer pricing issues and to identify them into a synthesis chart. The comparison has to be as wide as possible. At that stage, the aim of the process is not to propose common criteria and consensual definitions which would be shared by all interested parties, but to identify all the different approaches.

Consultation

The synthesis chart would then be communicated to the different interested parties in order that they identify what should be commonly considered as the main elements of the intangibles transfer pricing issues. This work should lead to a consensus relating to the definition of intangibles, to their allocation method and to their valuation, in order to answer to the shortfalls identified in §2.

4. FORMAT OF THE FINAL OUTPUT OF THE OECD WORK

We believe that the final output of the OECD work should propose additional principles concerning the intangibles transfer pricing issues identified above. These principles have to be thought in a very practical way and have to be applicable to every situation. However, lists of intangibles/transactions which may fall into the scope of Chapter VI and VIII cannot be the only conclusion resulting from the OECD work, due to the fact that they are necessarily limited to specific situations and cannot have a general scope.

The principles should be sufficiently detailed in order to be applicable and understood by all interested parties. In that way, it would be relevant to define any technical terms which may be used in order to avoid any misunderstanding: a given term may indeed have a different meaning depending from its author (ex: lawyer vs economist). Consequently, an intensive work should be made in order to propose a common language for the description of the intangibles transfer pricing principles.