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Dear Mr. Andrus,

RE: Comments on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles

De Witte-Viselé Associates ("DWVA") thanks you for the opportunity given to comment on this revision of Chapter VI of the OECD Transfer Pricing Guidelines dealing with the Special Considerations for Intangibles ("Chapter VI TPG") issued on 30 July 2013.

We are pleased to provide you hereby with our comments with respect to this revision and hope our contribution can help reaching a consensus on a common treatment of intangible assets.

In the meantime we remain at your disposal for any further explanation regarding the comments we made.

Sincerely,

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Comments regarding the amendments to section D.6. of Chapter I-III regarding the Location Savings

The suggested amendment to Section D6 of Chapter I-III provides a definition of what are location savings and other local market conditions. The section also provides some high level guidance on how to treat them from a transfer pricing perspective.

We conceptually agree on the definition made by the OECD of both concepts and in particular on the local market features that can be taken into account in the comparability analysis when carried out a transfer pricing analysis relative to certain specific markets.

The OECD recommends considering local market features that may affect the arm's length price with respect to transactions between associated enterprises. §7 suggests either looking for comparable transactions in the local market or carrying comparability agreements for such local market features. Although this is a valid point from a pure theoretical perspective, we are however concerned how such a recommendation can be interpreted by the local tax authorities.

We recommend the OECD to clearly set the boundaries of such a requirement to avoid local tax authorities imposing systematically local comparable search analyses (or location specific comparability adjustments) to be carried out for each transfer pricing analysis. How far should one go in considering local market features? Would regional benchmarking analyses (e.g. Pan-European) be questionable based on this guidance?

Comments regarding Chapter VI of the TPG

A. <u>Identifying intangibles</u>

The new version of the intangibles' definition clearly acknowledges, in the introduction (§ 39), the difficult trade-off between the adoption of a narrow definition of the intangibles which may fail to capture part of the profit potentially attributable to them and a broader definition which may rise intangible issues where no intangible is actually involved. We welcome the introduction in the definition of the intangibles a reference to what would have happened between independent parties.

We also understand the willingness of the OECD to avoid making a distinction between "soft" and "hard" intangibles or "routine" and "non-routine" intangibles. We however are of the opinion that the notion of unique and valuable intangibles may naturally be distinguished since certain intangibles are creating a clear competitive advantage against other intangibles which, although necessary for the operation of a company, can be found elsewhere on the market.

The following comments will enter into some definitional issues we identified in particular regarding the notion of Goodwill.

Notion of goodwill and ongoing concern

The OECD defines in the Chapter VI TPG a number of intangibles which sometimes the notion of Goodwill in a quite different meaning that §60 to 62 is trying to make.

Section "*(vi) Goodwill and ongoing concern value*" defines the goodwill as an intangible in order to "*assure that such values are taken into account in appropriate situations*" OECD, Chapter VI TPG, §61. Although we acknowledge that independent parties do pay for such a concept in the context of business acquisitions, we doubt independent parties would actually be willing to pay for the use or transfer of rights over goodwill as such.

The question is different in the context of a business acquisition where the goodwill represents an extra value that can be derived from the operation of a company, together with its different assets (tangibles and intangibles). As rightfully mentioned in §60 Chapter VI TPG, we are of the opinion that Goodwill cannot be separated from the other assets and the operation of a company and can only be considered in a transfer pricing analysis in the context of a business acquisition (or going concern), but cannot form the base for a recurring remuneration for an intangible asset.

§57 relative to the concepts of brand seems to move away from the above definition of goodwill by including/attributing the Goodwill into the brand value; "*A brand may, in fact, represent a combination of intangibles including, among others, trademarks, trade names, customer relationships, reputational characteristics, and goodwill.*" We respectfully disagree on referring to goodwill while speaking of other intangibles, goodwill is a value paid in the context of business acquisitions and separated from other intangible assets.

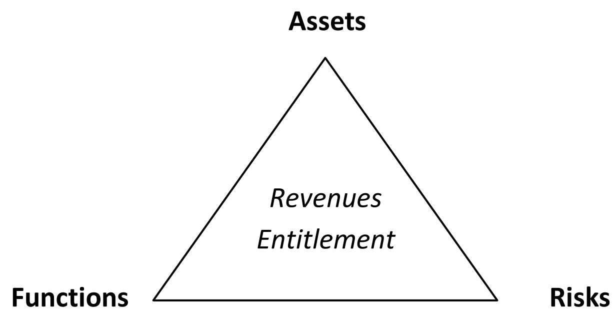
B. Ownership of intangibles

The Chapter VI TPG makes a clear distinction in §73 between the legal ownership of the intangibles and the ultimate right to retain any return from exploiting the intangible (economic ownership). According to Chapter VI TPG, the entitlement to intangible related revenues depends on the *contributions made to the anticipated value of the intangibles*.

Although we agree on the general principle that only the companies actually participating to the development of the intangibles should be entitled to the income derived from its exploitation, we are of the opinion that the current wording used may give too much importance on the actual conduction of certain key functions, underestimating the importance of other elements such as financing, control and risk management.

The Chapter VI TPG articulates the contribution made to the anticipated value of the intangibles, or economic ownership (and, in fine, the entitlement to intangible related returns) around three main factors:

<u>Figure 1</u> : Elements of Revenue Entitlement[1]



1. <u>Functions (including the actual control of the functions)</u>

From a general perspective, the OECD prescribes that all **the important functions** (e.g. design, control of research and marketing programmes, management and control of budgets, control over strategic decisions regarding intangibles development programmes) **are controlled** by the entity claiming for the intangibles related returns (§76-78). Should any of the important functions be outsourced, their remuneration should be fixed at arm's length, considering in some cases profit split methods (§80).

2. <u>Assets</u>

The entitlement to the intangibles related return is also function of the asset contribution in the development, enhancement, maintenance and protection of the intangible assets. The OECD insist in the Chapter VI PTG that funding and bearing a "*simple*" financing risk does not suffice to pretend to any intangible related revenue. At the most, such risk bearing activity would entitle the entity to a **risk adjusted return**.

We understand while the reading the guidelines that the entity, on top of funding the development process of intangible assets, should at least control part of the important functions (§82) and/or bear other significant risks related to the exploitation and/or development of the intangible assets (§83-84) to pretend to intangible related returns.

3. <u>Risks</u>

As far as the risk assumption is concerned, Chapter VI TPG insists on the importance of evidencing similar allocation of risk in comparable uncontrolled transaction (§85), demonstrating a sufficient level of control over the key risks and having the financial capacity to assume such risks (§86). A different

[1] We considered the control of the function as one element of intangible ownership as Chapter VI TPG insists in §76 that it is the control of function that matters the most.

allocation of the risks among related parties should be compensated at arm's length. The OECD then identifies the following risks as been important: Development risk; product obsolescence, infringement risk, product liability and similar risks (§87).

COMMENTS

Revenues Entitlement Requirements

Although Chapter VI TPG sets out a relatively clear framework for the analysis of the entitlement to intangible revenues, the Summary made in § 89 and 90 is relatively strict and vague. On the one hand, the OECD imposes that an entity should centralise the functions, control, risks and assets in order to be entitled to the intangible assets' revenues. The answer is indeed pretty clear in situations where one entity centralises the control of all the key functions, all the assets and all the risks, however the OECD does not address those many cases where the three elements are not centralized (as it is sometimes the case between third parties). In case no comparable transaction can be identified and the analysis should be carried out based on the allocation of functions, risks and assets, the OECD seems to give more importance to the actual conduction of the important functions rather than the risk allocation or provision of the assets.

Additional guidelines relative to the minimal requirements for the entitlement to intangible related revenues would be welcomed in order to analyse those conditions in cases where (as it is mostly the case) no comparable exist on the market to compare the situation of the tested party. The guidelines as currently drafted seem to struggle giving a clear cut answer to this question.

Intangibles Funding

The OECD insists in Chapter VI TPG that the main provision of the assets (e.g. funding) does not grant the right to intangibles related revenues nor does the mere risk assumption. Instead, the OECD states in § 84 that funding an intangible development and bearing the related funding risk "(...) *would entitle the funder to a **risk adjusted rate** [emphasis added] or anticipated return on its capital invested, but not more.*". We are wondering what such a "risk adjusted rate" practically represents. The "risk adjusted rate" or, as mentioned by the OECD, the "anticipated return on its capital invested" is similar in our view to part of the return generated by the exploitation of the intangibles (determined for example through the application of a profit split method). In such a case, how does the funding of the intangible development differ from the entitlement to a part of the intangibles revenues? Funding would indeed, up to a certain extent, grant rights over the intangibles revenues. This would in our opinion be a fair statement to add to Chapter VI TPG as any entity investing in the development of an intangible asset and bearing the related risk indeed expects to receive part of the potential revenues generated by the intangible. This is also a fundamental aspect of the cost contribution arrangements where all the entities involved participate according to their expected benefits and become economic co-owner of the developed intangibles.

Practical Aspects of Revenues Attribution

Practically speaking, should a company significantly contributing to an intangible's value without being the legal owner directly charge royalties for the use of the intangibles? Such situation is not likely to happen between independent parties ! How a company carrying out, e.g. research activities, claim royalties for a patent it does not own?

Certain practical aspects of the intangible related revenue attribution, although crucial, are not sufficiently emphasized in the current version of the guidelines. In the day-to-day business operation, it is the legal owner who generally grants the (legal) right over the intangibles related returns (or transfer of intangible).

§65 already acknowledge that when stating:

> *"Although the legal **owner of an intangible may initially be entitled to receive the proceeds from exploitation or transfer of the intangible** [emphasis added], other members of the owner's MNE group may have performed functions, used or contributed assets, or assumed risks that are anticipated to contribute to the value of the intangible and for which they must be compensated under the arm's length principle".*

Another example of this dynamic can also be found in §73:

> *"In most cases, the **legal owner will accrue receipts from the exploitation of the intangible in the first instance** [emphasis added]. It must remit to other MNE group members arm's length remuneration reflecting the anticipated value of their contributions."*

§ 86 then requires, without much explanations, the legal owner to compensate other group members for their risks borne and their contribution in the intangibles value, which imply that the legal owner receives the intangibles' revenues in the first place:

> *"The legal owner may bear and control risks associated with the development, enhancement, maintenance and protection of the intangibles. If instead other members of the group bear or control such risks, the **legal owner of the intangibles must compensate such members** [emphasis added] for the anticipated value of their contributions, including the risk they assume."*

Chapter VI TPG would benefit from more clarification with respect to the expected flows of profitability given that it is generally the legal owner which is (legally) entitled to charge royalties for the use of intangible or transfer intangible assets. When it comes afterwards to the appropriate allocation of profit for transfer pricing purposes, we then understand that the allocation of intangible revenues should be re-distributed among the different contributors either as part of the general transfer pricing model, through a modification of the methodology used for the product or service transfer pricing, or by the creation of additional transactions, when applying a profit split method for example.

C. Transactions involving the USE or TRANSFER of intangibles

We welcome the clear distinction made in this revised version between the transfer and the use of intangibles or rights in intangibles.

Goodwill consideration in the context of the transfer of intangibles

The paragraph § 113 of Chapter VI TPG mentions that all the intangibles transferred in a particular transaction have to be identified. However, the paragraph also mentions that the transfer of certain intangible assets can be accompanied by other values such as reputational value or Goodwill. We would like to insist on the fact that goodwill can in our opinion only be valued in the context of a business acquisition when, as it is mentioned in Example 16, it would be treated as goodwill in a purchase price allocation for accounting and business valuation purposes. In other words, only the transfer of a mix of assets and intangibles capable of operating together may be susceptible to create a goodwill that independent parties would be willing to pay for.

As we already mentioned in our comments relative to the definition of Goodwill, we estimate that the transfer of a single intangible asset such as the trademark should not embed goodwill. Should a reputational value be attached to the trademark, such element should be either valued as such or taken into account in the trademark valuation exercise. In all instances we recommend to avoid assimilating the reputational value with the Goodwill as a whole, as the latter may encompass other concepts not related to the trademark[2].

Choice of the transfer pricing method and characterisation of the transaction

The OECD mentions in its Chapter VI TPG §120 that the characterisation of the transaction does not necessarily dictate the use of a particular transfer pricing method. A cost plus method may for example not be appropriate for service transactions where intangibles are involved. We are of the opinion that such wording may create more confusion in the taxpayers mind rather than solving issues.

Chapter I-III recommends looking at characterisation of the transactions as a determinant for the transfer pricing method to be applied. We believe that those principles should still apply in the context of intangible related remuneration. Should only an intangible (or right in intangibles) TRANSFER (i.e. not USE) occur between two entities, an appropriate method could be determined for such specific transaction. Alternatively, should a mix of services and intangibles be provided/transferred, the determination of the remuneration for the "service part" of the transaction and the "intangible part" are two separate matters. However, even though different transactions may be identified one may decide to aggregate the transactions together for the purpose of the analysis, hence changing the transfer pricing method to be used. Looking from a different perspective, we doubt the tax authorities

[2] Other examples of such an assimilation of Goodwill with intangible value can be found in the following paragraph: §100 and §114.

may be keen to accept service transactions (should they involve intangible assets) that are not remunerated at least on a cost plus basis (through the application of a profit split for example).

D. Determination of the Arm's length Conditions in Cases Involving Intangibles

The Chapter VI TPG recommends in the context of the determination of the arm's length conditions in cases involving intangible assets to analyse the situation of both parties to the transactions together options realistically available to the parties in order to optimize the resource allocation between the parties. We fully understand such a requirement in the case of the transfer of intangible (or rights in intangibles), however we do not consider this a necessary step in the context of the use of intangible where one-sided methods can be appropriate. We believe such clarification is important to be made in Chapter VI TPG.

Although the analysis of the options realistically available to the parties may help understanding the bargaining power of both parties, a systematic requirement to such an analysis may be burdensome in all circumstances. We encourage the OECD to further develop the conditions under which such an analysis is required and to what end. Alternatively it may limit such requirement when other evident alternative transactions have not been chosen (e.g. granting an exclusive right to use and exploit an intangible versus an actual transfer of the intangible).

1. Transfer of intangibles

In the case of transfer of intangibles, the OECD recommends a quite holistic approach the analysis, analysing the economic consequences of the transactions, through the conduction for example of a global functional analysis. In absence of a CUP, the OECD basically recommends the use of either a Profit Split Method (e.g. in case of partially developed intangibles) or a valuation technique.

We welcome the modification of the guidelines in the sense that financial valuation carried out may help the transfer pricing analysis, although with caution. However we are of the opinion that requiring a functional analysis describing the global business process of a group may be too burdensome in some cases involving the transfer of intangible assets.

As it is the case for business restructuring, a description of the envisaged intangible transfer, the entities involved and an identification of the shift in profitability should suffice to document such transactions. Additional documentation could also be provided to justify the new transfer pricing methods used in cases where the intangible transfer had an effect on the intercompany remuneration scheme.

2. Highly uncertain valuations

The OECD announces in the introduction of section D3 that further work is still to be foreseen on the treatment of "*hard to value intangibles*". We greatly welcome this initiative as we are of the opinion that, per definition, an intangible valuation is a difficult exercise and that, without further guidance on this topic, the comments made in section D3 could therefore easily apply to all intangible valuations.

In particular, we would welcome more guidance on the following aspect of the treatment of the "*hard to value intangible*":

- An exact definition of such intangibles and what differentiate them from other, let's say, "*easy to value intangible*" (if that even exists);

  As the OECD rightfully mentions in its guidelines, many transactions taking place in an intercompany context are difficult to find between independent enterprises. Most of these transactions (where no CUP is available) may therefore easily fall under the definition of "hard to value intangibles" since no market reference can be found to support the hypotheses used in the transfer pricing analysis. In order to avoid that all intercompany transactions that has no market reference fall under this category of transactions we would welcome more guidance on the definition of such intangibles.

- Valuation criteria that may be subject to a modification/renegotiation for those intangibles and, therefore, modifying the anticipated value of the intangible;

  One of the most unpredictable criteria is the market potential of an intangible. The other criteria, although they may have a material impact on the valuation, are debatable up-front and agreed prior to the transaction (e.g. discount rates, useful life of the intangible, tax effects).

  More guidance of the OECD on the criteria that are likely to vary/be uncertain when valuing those intangibles may also help the analysis and helping to better set the boundaries of such renegotiation clauses.

- The circumstances under which independent parties would have insisted in having an adjustment clause should even exist.

  The adjustment of the contractual clauses is generally foreseen in case of long term relationship between parties (e.g. in case of licensing agreements) where the benefits of the parties derived from an intangible may vary during the lifetime of the intangible.

  We however are more doubtful about the existence of such clauses in case of a definitive transfer of intangible assets or right in intangible assets paid, e.g., in the form of a one off lump sum payment.

3. Use of intangible assets

The OECD recommends the use of the PSM method in case no comparable can be identified to determine the arm's length price of such a transaction. Apart from the administrative burden that such a rule may represent, we are unsure such a method would represent what would have been agreed between third parties and how such a method should be contractually set up in practice.

E. Further guidance expected

The OECD demonstrated in these guidelines a clear preference for the CUP method and Profit Split for the analysis of most of the transactions involving the transfer or intangibles or rights in intangibles.

Although we understand the reasons underlying this position in the context of the BEPS Action Plan, we now urge the OECD to expand the existing guidance on the application of the Profit Split method and their application in an intangible context.

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