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Mr Pascal Saint-Amans

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FRANCE

01st October 2013

Dear Mr Saint-Amans,

REVISED DISCUSSION DRAFT ON TRANSFER PRICING ASPECTS OF INTANGIBLES: 30 JULY 2013

Introduction

Diageo plc welcomes the opportunity to comment on OECD's Revised Discussion Draft on Transfer Pricing Aspects of Intangibles, and in so doing acknowledges the considerable efforts of the OECD team in covering this challenging area of transfer pricing so comprehensively.

Diageo is a major Multinational Group, domiciled in the UK, and listed on the London (FTSE 100) and New York (NYSE) Stock Exchanges. It is the world's leading premium drinks business, and owns a range of global iconic brands, including Smirnoff, Johnnie Walker, Captain Morgan, Baileys and Guinness. Diageo has extensive production facilities across the world, and sells in more than 180 markets through its own local sales and marketing companies, or through independent distributors.

With much of Diageo's value lying in its intangible assets, and in particular in its brands, the attribution of economic ownership and allocation of profits to intangible assets is of great importance to the company, and we warmly welcome OECD's continued efforts to provide improved guidance in this area to taxpayers and tax authorities alike.

Overview Comments

The on-going "BEPS" debate highlights both the inherent ease of moving intangible assets within an MNE group (thereby shifting taxable income), and the increasing source of concern of tax authorities around avoidance in this area.

Diageo believes the inappropriate manipulation by MNEs of intangible assets, and in particular the artificial separation of ownership of the intangibles from the activities to which they relate, should be actively discouraged. However, we also think it important that the OECD Guidelines (and Chapter VI in particular) retain their essential character as a source of objective and authoritative guidance for both tax authorities and taxpayers alike. We think it would be unfortunate Chapter VI was narrowly positioned – or, indeed, perceived - as an anti-avoidance document.

While this objective is substantially achieved, we believe it would be improved by placing additional emphasis on three key principles, none of which, we believe, is controversial.

Hindsight

The use of hindsight by tax authorities – as is made clear elsewhere in the OECD Guidelines – is unacceptable. It is in the area of intangibles, however, where the boundary between what is or is not hindsight is most difficult to define, and we would respectfully encourage OECD to keep this in mind when drafting the outstanding section of Chapter 6, on intangibles where the valuation is highly uncertain.

Independent parties regularly undertake transactions which involve intangibles of uncertain value, and have to do the best they can. In many situations it is not possible to reserve your position in an arm's length negotiation, and it is necessary to take a reasonable view of the value or potential of an intangible, and accept the inherent risk. We think it important that Chapter VI presents a balanced picture, discouraging avoidance (as described earlier), but also maintaining the true character of "arm's length", which necessarily involves the acceptance of an element of uncertainty and risk.

An additional paragraph to this effect would, we feel, help to maintain this balance.

Re-Characterisation

While this revised draft confirms that Chapters I – III of the Guidelines apply equally to intangibles as to other assets, the surprisingly frequent references to "re-characterisation" in the draft are, in our view, largely unnecessary, and may in their totality convey the wrong message.

The relevant part of Chapter 1 of the OECD Guidelines limits re-characterisation to exceptional cases, which is essential for the reasons given therein. If it is considered necessary to retain in Chapter VI the many separate references to re-characterisation, we would respectfully suggest that either para 37 (which confirms the applicability of Chapters I-III) or para 126 is amplified to make very clear that nothing in Chapter VI should be read as lowering the general threshold for re-characterisation.

Double Taxation v Double Non-Taxation

Finally, while the manipulation of intangible assets in MNE groups has been identified – with justification – as an area requiring action in order to counter the risk of *double non-taxation*, we would respectfully suggest Chapter VI places the elimination of double taxation and the elimination of double non-taxation on equal footings.

While this may be thought implicit in the draft, we believe it would benefit everyone if the comment was made explicitly.

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Specific Comments

We have included some more specific comments in an appendix to this note.

Conclusion

We would congratulate OECD once again for the quality and comprehensiveness of this draft, which we believe is a significant step forward.

While we appreciate it cannot be unconnected with the wider “BEPS” agenda, and the very legitimate international concerns around tax avoidance, we do believe the authority of and the respect for the OECD Guidelines is rooted in its essential character as an objective document aimed equally at taxpayers and tax authorities.

We would respectfully suggest our comments made above could both be easily incorporated into the draft, and would help to protect the objective and impartial credentials of the OECD Guidelines.

We look forward to seeing in due course the further draft (referred to in Section D3) on intangibles of highly uncertain valuation, and would welcome the opportunity to comment, given its importance.

Yours sincerely,

Paul Fox

Tax Director

DIAGEO

Appendix

Marketing Intangibles

The existence (or non-existence) of marketing intangibles, particularly with regard to local sales and distribution companies, continues to be the subject of intense debate, and we applaud OECD for addressing this issue, via both the improved definition of “marketing intangible” (para 50) and by the proposed addition to Chapter 1 (paras 1-34).

However, we would respectfully suggest that the new definition of *“marketing intangible”* could be better aligned with the definitions of *“unique and valuable” intangibles* (para 51) and *“non-unique” intangibles* (para 44). In particular, we think it is worth emphasising that the types of intangible included in the definition of “marketing intangible” could – depending on the particular facts – be “unique and valuable” intangibles, or “non-unique” intangibles.

Customer lists, or customer relationships, for example, may be seen as the sort of “non-unique” intangibles that any competent distributor would have; the same might be said about market and customer data, which – even if proprietary – is part of the normal apparatus of a distributor. It would only be in exceptional cases that such intangibles might have particular characteristics which make them unique and unusually valuable.

Trademarks or brands, on the other hand, are by their nature unique, but it is not their uniqueness that necessarily makes them valuable. At one end of the spectrum, global iconic brands may become extremely valuable, driven by the successful global commercialisation effort of the brand owner; at the other end, local brands attaching to slow-selling products may have little intrinsic value.

While the definition of *“unique and valuable intangibles”* (para 51) is helpful, we think subsection (i) could be amplified; a unique and valuable intangible may be broadly the same sort of intangible as seen in competitors, but with some special or unique feature; alternately, it may be an additional intangible over and above what comparable companies have.

It may also be worth developing a parallel definition of *"non-unique" intangibles*, to bring out more clearly the principle that, although they generally have value (in that they are necessary in order to operate) they are the sort of intangibles you would expect to see in most potentially comparable companies.

A further general point which may merit addition is that the fact a company is perceived to be better at what it does than its competitors is not of itself reason to make a comparability adjustment; there have to be different or distinguishable intangibles underlying the difference in performance.

"Important functions"

Para 79 notes – with relation to intangibles – that some functions will be more important than others, and will have "special significance".

While this is probably right, each case must surely be considered on its individual facts – hence, it is probably unhelpful to list functions which would "generally" be expected to be important, as this may not necessarily be the case. The items listed are, in any event, in some instances rather vague, and in other instances debatable.

In particular, the inclusion of "management and control of budgets" is surprising, given the exclusion from the list of acceptance of financial risk.

Return Attributable to an Intangible

We agree with the broad direction of paras 65-66, and with the framework set out in para 66 for attributing returns in line with respective contributions related to the developing, enhancing, maintaining and protecting the intangible asset.

However, we think it bears emphasis that a party contributing routine services on a cost plus reward basis, and not sharing materially in the financial investment risk, would not normally be entitled to claim additional reward in the event of the intangible's value greatly exceeding expectations. The same might be said of a local distributor, whose resale-minus pricing basis would normally be adequate reward.

We think it important to emphasize that where an intangible becomes unusually valuable, any element of "super" profit should be shared only among those parties making a unique contribution or taking the major financial risk.

We would also say, with respect, the inclusion in the para 66 framework of a sixth and final step of a possible re-characterisation is inappropriate, and does not sit well with the five key steps which precede it.

Proposed Addition to Chapter 1 (Paras 1-34)

We congratulate OECD in directly addressing these difficult areas; a general comment would be that many of the factors identified which might merit adjustment in a comparability analysis appear very difficult to quantify. We would respectfully suggest that where the taxpayer has made a reasonable and objective attempt to undertake a comparability analysis, the Guidelines should encourage a tax authority to respect it.

MNE Group Synergies

We believe the guidance on group synergies is generally helpful, and also agree with the over-riding principle that MNE group members should not be required to pay for the "passive" benefits of group membership. We would, however, draw your attention to the following concern.

Para 18 introduces the concept of "negative synergies", using the example of a local company being required to adopt group-wide IT or communications systems, which it would not otherwise have adopted. With respect, this sort of comment is unhelpful in the wider context; intra-group re-charges are very much a "live" issue in international tax audits, and there is a risk that para 18 might be seized upon by tax authorities as sufficient justification for disallowance of intra-group service charges, without a full prior analysis of the facts.

We would, in any event, suggest the better approach is to look at MNE synergies is in a holistic way, weighing the various advantages of group membership (which, as the Guidelines make clear should not normally attract a charge) with the obligations or commitments necessary to make the group work to the advantages of its members – and with each member paying its fair share.

It is taking a very narrow view to suggest an MNE member does not ultimately derive a benefit from common IT or communications systems, particularly where – as is usually the case – other MNE group members are significant trading partners.

We believe it would help maintain a sense of balance if the Guidelines encourage a holistic approach to MNE synergies, rather than require specific factors to be considered in isolation – an approach which can only increase the number of transfer price disputes around intra-group charges.

We would also comment on paras 24-27, which examine two situations where parental support is given to subsidiaries which are raising funds externally. We agree with the underlying principle – i.e. that the subsidiary should pay only for the incremental benefit of the actual guarantee, but not for the inherent benefit of simply being a member of the group.

We wonder, however, if the examples as written fully reflect this principle. The examples cover the notion of a group member having an “implicit” guarantee, but do not recognise that the strong credit rating of the parent is surely due in part to the very existence of the subsidiary beneath it. We believe this also needs be taken into account in computing the guarantee fee, and would suggest a short additional sentence to this effect.