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September 30, 2013

VIA E-MAIL

Mr. Pascal Saint-Amans
Director, Center for Tax Policy and Administration (CTPA)
OECD, 2, rue André Pascal
75775 Oarus / Cedex 16
France

Re: Comments on the OECD's *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles*

Dear Mr. Saint-Amans,

This letter is in response to the request for comments on the OECD's *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* ("***RDD***"), issued July 30, 2013. I'm writing to share the views as representative of, and on behalf of, the Information Technology Industry Council ("ITI"),[1] Semiconductor Industry Association ("SIA"),[2] the Software Finance and Tax Executives Council (SoFTEC),[3] TechAmerica,[4] and TechNet.[5]

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[1] ITI is the premier advocacy and policy organization for many of the world's leading innovation companies. ITI navigates the constantly changing relationships between policymakers, companies, and non-governmental organizations. ITI engages in policy advocacy and provides creative solutions that advance the development and use of technology around the world. ITI matches its members' breakthrough innovations with cutting-edge approaches to help people and governments better understand our members and the work they do.

[2] SIA is the leading voice of the U.S. semiconductor industry. SIA represents U.S. companies involved in research, design, and manufacture of semiconductors. Semiconductors are a foundation of the information technology sector and essential to modern communications, entertainment, national defense, health care, transportation, and other aspects of the world's economy. SIA works to encourage policies and regulations that fuel innovation, propel business, and drive international competition in order to maintain a thriving semiconductor industry in the United States.

[3] SoFTEC is a trade association providing software industry focused public policy advocacy in the areas of tax, finance, and accounting. SoFTEC represents the leading developers of software and is the voice of the U.S. software industry on tax issues.

The RDD was issued soon after the OECD released the *Action Plan on Base Erosion and Profit Shifting*, on July 29, 2013, which discusses transfer pricing issues. Given the relatively short period before the comment deadline, and the length and scope of the RDD, our comments here should be taken as preliminary—we focus on a few provisions of the RDD, as described below. We may submit further, or revised, comments after October 1, 2013.

I. Introduction

We thank Working Party No. 6 for preparing the RDD and for asking interested parties to give written comments. We appreciate that the RDD is an interim draft, and so may not reflect consensus among all the members.

The RDD improved in several ways on, and affirmed certain conclusions from, the *Discussion Draft—Revision of the Special Consideration for Intangibles in Chapter VI of the OECD Transfer Pricing Guidelines and Related Provisions*. For example, the RDD treats location savings, market features, assembled workforce, and group synergies not as intangibles but rather as comparability factors. It also clarifies that not all intangibles generate premium returns. The RDD additionally clarifies that not all R&D or marketing expenses create or enhance intangibles.

Transfer pricing of intangibles is complex, and the analysis should be based on foundational principles. These principles should form an actual, and not merely nominal, touchstone for analyzing such transfer pricing. Immediately below we discuss these foundational principles and our concerns with how the RDD handles these principles.

A. The arm's length principle should not be distorted by prescriptive approaches.

One of our main concerns is that the RDD, while proposing changes to Chapter VI of the *Transfer Pricing Guidelines* ("***TPGs***") nominally in the context of determining "conditions . . . [that] would be made between independent enterprises," treats the arm's length principle as something malleable to justify a prescriptive or pre-determined outcome. The arm's length

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4 TechAmerica is the leading voice for the U.S. technology industry—the driving force behind productivity growth and jobs creation in the U.S. and the foundation of the global innovation economy. Representing approximately 1,000 member companies of all sizes from the public and commercial sectors of the economy, it is the industry's largest advocacy organization. TechAmerica is also the technology industry's only grassroots-to-global advocacy network.

5 TechNet is the U.S. national, bipartisan network of CEOs that promotes the growth of technology industries and the economy by building long-term relationships between technology leaders and policymakers and by advocating a targeted policy agenda. TechNet's members represent more than one million employees in the fields of information technology, biotechnology, e-commerce and finance.

principle should be applied consistent with the conduct of independent enterprises, based on the facts and circumstances of each situation. The RDD conforms to the arm's length principle when it endorses transfer pricing outcomes consistent with the conduct of independent enterprises, based on facts and circumstances. But when the RDD posits arm's length behavior or outcomes inconsistent with the behavior of independent enterprises—and we discuss examples of this below—the RDD strays from that principle.

B. The arm's length principle is the only reliable benchmark parties can look to in evaluating the pricing of transactions.

Transfer pricing disputes involving tax treaties can sometimes be settled through a Mutual Agreement Procedure ("***MAP***") approach like that in Article 25 of the OECD Model Tax Convention. The MAP can work because the Competent Authorities share a common goal—correct application of the arm's length principle to the facts and circumstances of particular cases, usually combined with a thorough functional analysis. Competent Authorities work within the commonly understood arm's length framework to try to reach a mutually acceptable outcome. Even with a shared understanding of the analytical framework for applying the arm's length principle, Competent Authorities may disagree on the application of the principle to the facts and circumstances of particular cases.

As described below, while the RDD nominally embraces a facts-and-circumstances application of the arm's length standard, in places it <u>prescribes</u> certain outcomes without regard to transactions of independent enterprises, which is inconsistent with the arm's length principle. This prescriptive approach would lower the chance of a successful MAP outcome in cases involving transfers of intangibles: one Competent Authority may embrace a prescriptive approach, while the other—proceeding from foundational principles—may try to find the most appropriate transfer pricing method and outcome relying on the arm's length principle. The arm's length principle would thereby lose its ability to mitigate double taxation and to operate as a dispute resolution mechanism with a commonly understood application.

If the OECD moves away from an arm's length principle based on transactions between independent enterprises (for example, by moving to a prescriptive approach for transfer pricing of intangibles), the OECD should, to mitigate the risk of double taxation, augment dispute resolution procedures under Article 25 of the OECD Model Tax Convention (Mutual Agreement Procedure) to include a requirement for binding arbitration.

C. The OECD should not presume that special measures "beyond the arm's length principle" are needed to cope with changes to business practices.

The *Action Plan on Base Erosion and Profit Shifting* ("***BEPS Action Plan***") discusses the transfer pricing of intangibles. We take this opportunity to comment on four points made in the BEPS Action Plan.

First, the BEPS Action Plan properly rejects formulary apportionment,[6] asserting that "rather than seeking to replace the current transfer pricing system [based on the arm's length principle], the best course is to directly address the flaws in the current system, in particular with respect to returns related to intangible assets . . . . Nevertheless, <u>special measures, either within or beyond the arm's length principle</u>, may be required with respect to intangible assets . . . ."[7] As discussed above, there are compelling reasons for retaining the existing arm's length principle, and rejecting "special measures" either to redefine the arm's length principle, or to move off it, when transfer pricing intangibles transactions. Transfer pricing constrained by the arm's length principle is often challenging to apply in practice. It doesn't follow, however, that business practices of independent enterprises don't keep pace with, or aren't as complex as, those involving associated enterprises.

Second, the BEPS Action Plan acknowledges that the arm's length principle in many instances "effectively and efficiently allocate[s] the income of multinationals among taxing jurisdictions," but asserts that in other instances "multinationals have been able to use and/or misapply those rules to separate income from the <u>economic activities</u> that produce that income and to shift it into low-tax environments. This most often results from transfers of intangibles and other mobile assets for less than full value . . . ."[8] As mentioned above, and as described in more detail below, the RDD in places prescribes activities—to the neglect of rights, ownership, and capital —as having overarching importance in transfer pricing analyses involving intangibles. This blanket prescription isn't consistent with the behavior of independent enterprises.

Third, Action 10 includes "clarify[ing] the circumstances in which transactions can be recharacterised" in situations involving transactions that "would not, or would only very rarely, occur between third parties."[9] As we discuss below, paragraph 1.65 of the current TPGs discusses two circumstances in which a tax administration "may, <u>exceptionally</u>" disregard a structure adopted by a taxpayer entering into a controlled transaction.[10] The first such circumstance is, unsurprisingly, if the economic substance of a transaction differs from its form. The second such circumstance is if the arrangements made in relation to the transaction "differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner <u>and</u> the actual structure practically impedes the tax administration

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6 *See*, TPGs, ¶¶ 1.19–1.32, explaining why formulary apportionment should be rejected.

7 BEPS Action Plan, p. 20 (emphasis added).

8 BEPS Action Plan, p. 19 (emphasis added).

9 BEPS Action Plan, pp. 20–21.

10 Emphasis added.

from determining an appropriate transfer price."[11] Associated enterprises behaving as independent enterprises do only shields against recharacterization if the behavior is determined to be "commercially rational." It's unclear how this determination is made. The potential for arbitrary action by a tax administration is, however, reduced by the observations that a determination that a controlled transaction isn't commercial rational must be made "with great caution,"[12] that these situations are "exceptional,"[13] and that recharacterization "generally is inappropriate."[14] It must follow that an appropriate transfer price—obtained through application of the (usual) arm's length principle—is almost always determinable. We recommend that Action 10 circumscribe what's meant by "commercially rational" behavior, and not broaden the set of conditions triggering potential recharacterization.

Fourth, Action 10 also involves "clarify[ing] the application of transfer pricing methods, in particular, profit splits, in the context of global value chains."[15] As discussed in general above, and in more detail below, prescriptions of appropriate transfer pricing methods are at odds with a facts-and-circumstances determination of the appropriate transfer pricing method.

II. Specific concerns

A. The expansive definition of intangible property should be pared back to be consistent with the arm's length principle.

1. Parties at arm's length would require a precise definition of any transferred intangible property.

The RDD asserts that "[i]t is not necessary for purposes of [Chapter VI] to establish a precise definition of goodwill on ongoing concern value for transfer pricing purposes."[16] This isn't consistent with the BEPS Action Plan, which, in signaling action to prevent BEPS by moving intangibles among group members, states that this "will involve adopting . . . [a] clearly delineated definition of intangibles."

[11] Emphasis added.

[12] TPG, ¶ 9.171.

[13] TPG, ¶¶ 1.65 and 9.171.

[14] TPG, ¶ 1.69.

[15] BEPS Action Plan, p. 21.

[16] RDD, ¶ 61.

2. An imprecise definition of intangible property can lead to inconsistencies, potential abuse, and double taxation.

Imprecise definitions of intangible property—including goodwill or ongoing concern value—transferred or allegedly transferred can compound the complexity of transfer pricing disputes, making them difficult to settle. Imprecision means Competent Authorities may take inconsistent positions, decreasing the likelihood of resolution and thereby increasing the possibility of double taxation.

3. Goodwill or ongoing concern value shouldn't presume to capture anticipated future profits from intangible property that doesn't yet exist (e.g., returns attributable to future R&D).

The RDD states that "goodwill is sometimes described as a representation of the future economic benefits associated with business assets that are not individually identified and separately recognized."[17] This description of goodwill raises serious questions. If the referenced "business assets" aren't individually identified or separately recognized, how does one know they exist? If "future economic benefits" are associated with such business assets, how does one know they exist? If "goodwill" is a "representation" of such benefits "associated with" such assets, is goodwill simply a number, a value, and not an intangible property itself?

This definition of goodwill includes possibly anticipated to-be-developed intangibles—i.e., intangibles not yet in existence but that may be created by future R&D efforts. Unrelated parties transfer existing intangibles expected to generate "future economic benefits." The arm's length principle would, however, be abandoned if transfer pricing adjustments were proposed based on non-existent intangibles. The definition of goodwill needs to be changed to prevent it being tied to intangibles that are yet to be, or may never be, developed in future, and to make it clear that it doesn't include value attributable to future R&D.

4. The broad definition of goodwill or ongoing concern value and the allocation of profit to such items on a residual basis would result in attribution to goodwill or ongoing concern value of returns from workforce and location savings—inconsistent with their treatment as comparability factors.

The RDD treats goodwill and ongoing concern value as intangibles, but treats MNE group synergies, workforce, and location savings as comparability factors to be applied in a transfer pricing analysis. The "residual" concepts of goodwill[18] or ongoing concern value,

[17] RDD, ¶ 61 (emphasis added).

[18] The RDD's alternative "residual" definitions of goodwill (RDD, ¶ 60) are that (i) it reflects the difference between the aggregate value of an operating business and the sum of the values of all separately identifiable tangible and intangible assets, or (ii) it's a representation of the future

will—in a situation involving transfer of an operating business—encompass value associated with any workforce or location savings. The potential for "double counting" in a transfer pricing adjustment would thus be present if, for example, goodwill were deemed transferred and a transfer pricing comparability adjustment was asserted for workforce. This casts further doubt on the notion of goodwill or ongoing concern value as intangibles for transfer pricing purposes.

B. At arm's length, contractual ownership rights and allocation of risk are respected independent of the exercise of "control" and the presence of other prescribed indicia

The generally appropriate directive under TPG guidance is for tax administrations to examine contractual terms between associated enterprises to see whether they have economic substance—determined by reference to the conduct of the enterprises—and are arm's length. The economic substance of a transaction or arrangement is determined by examining all facts and circumstances, such as the economic and commercial context of the transaction or arrangement, its object and effect from a practical and business point of view, and the conduct of the parties, including the functions performed, assets used and risks assumed by them.[19]

Section B of the RDD—dealing with intangible ownership and intangible related returns—is concerning because in places it makes assumptions of behavior that are inconsistent with behavior of independent enterprises. Among independent enterprises, ownership of intangible property is generally controlling. Below we point out some specific concerns.

The notion of "anticipated value" of intangibles discussed in paragraph 73 of the RDD is overly broad. The RDD asserts that the return ultimately retained by the legal owner of intangibles depends on "contributions . . . to the anticipated value of the intangibles" made by both the owner and by other MNE group members through functions performed, assets used, and risks assumed.[20] Although it's unclear, the "anticipated value" of (existing) intangibles presumably refers to the future value of those intangibles. This reading is supported by the further assertion in the RDD that if "the legal owner makes no contributions . . . anticipated to enhance the value of the intangible, the legal owner will not ultimately be entitled to retain any portion of the return attributable to the intangible."[21] With these assertions the RDD presumes that the value of existing intangibles can be anticipated to grow based on functions performed, assets used, or risks assumed by members of an MNE group. While this might be true in some cases, it's also possible (even probable) that the value of existing intangibles drops through

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economic benefits associated with business assets not individually identified and separately recognized.

[19] TPGs, ¶ 9.170.

[20] RDD, ¶ 73.

[21] *Id.*

obsolescence. The further assertion is inconsistent with the arm's length principle. It might be that functions, assets, or risks of other MNE group members are anticipated to enhance the future value of existing intangibles, and if so then at arm's length those other members might be entitled to compensation from the owner. It might also be, however, that no such value-enhancing functions are done, assets are owned, or risks are assumed by any member of an MNE group. In either case, however, it cannot reasonably be asserted that the owner isn't entitled to keep any portion of the intangible related return unless the owner makes such contributions. Owners of intangibles expect, at arm's length, to earn returns attributable to those intangibles; this is so whether or not the owner makes <u>any</u> contribution anticipated to enhance the future value of the intangibles. We recommend that paragraph 73 be clarified to reflect this.

The approach to "control" in paragraph 76 and examples 11–14 of the RDD is also overly broad. Paragraph 76 asserts that if the legal owner of intangibles is "to be entitled ultimately to retain the returns attributable to the intangibles," it will either perform certain functions or arrange to have such functions performed "under its control" by independent enterprises or by associated enterprises. The paragraph states that any party performing outsourced functions "should operate under the control of the legal owner," and that in assessing what member of an MNE group "in fact controls the performance of the relevant functions," principles analogous to those of paragraphs 9.23 to 9.28 should apply.

At arm's length, legal consequences flow from the right of control. For example, under agency law principles a principal's right to control an agent's actions within a scope may result in those actions being attributed to the principal. It's the right of control, rather than its exercise, that governs the outcome. Exercise of control of outsourced functions can, among independent enterprises, be tenuous. The "fund manager" example in paragraph 9.25 illustrates that a service provider hired for particular expertise may be subject to only minimal control—in that case simply the client's control over whether to hire, the extent of investment authority delegated, and the amount to invest. Examples 11–14, however, suggest a greater degree of control over R&D functions is necessary than is outlined in paragraphs 9.23 to 9.28. We recommend that these examples be changed to reflect the guidance in those paragraphs.

Paragraphs 79 and 80 of the RDD also raise concerns. Paragraph 79 of the RDD discusses "important functions" asserted to have "special significance." Paragraph 80 asserts that an intangible's legal owner claiming the right ultimately to retain all or material parts of an intangible related return "will generally perform, through its own employees" certain "more important functions"—described as including design and control of research and marketing programmes, management and control of budgets, control over strategic decisions regarding intangible development programmes, important decisions regarding defense and protection of intangibles, and ongoing quality control over functions performed by independent or associated enterprises.[22] The RDD further claims that if the legal owner outsources most or all of such important functions to other group members, "the entitlement of the legal owner to retain any material portion of the return attributable to the intangibles after compensating other group members for their functions is highly doubtful."

These paragraphs don't distinguish between functions performed with respect to existing intangibles, and those performed with respect to to-be-developed intangibles. A person who gets (legal) ownership of intangibles by paying an arm's length price for them is entitled to the returns attributable to those intangibles. This is the case whether those intangibles are simply commercially exploited, or whether they're also used in R&D to create new intangibles. Examples 13 and 14—which assume a transferee who pays an arm's length price for intangibles—should be revised to clarify that the transferee entity is entitled to all returns attributable to those (existing) intangibles.

There are common situations among unrelated parties in which a legal owner of an intangible is entitled to virtually all intangible related returns. The facts of these situations are inconsistent with the presumptions in paragraph 80. These real world outcomes arise because courts generally find legal ownership of intangibles or contractual rights to use intangibles controlling for purposes of awarding such returns. For example, persons with sufficient capital (so-called "patent aggregators") but virtually no other assets buy patent portfolios and hire service providers to help enforce their patent rights against third parties. The aggregator will likely itself have performed none of the "more important functions," and may have outsourced to a law firm much of the defense and protection of the intangibles. The only "control" exercised by the aggregator in this case may be the decision to hire the law firm and the extent of authority given the law firm. These control indicia align with the facts of the "fund manager" example in paragraph 9.25 of the TPGs. As another example, a product manufacturer that, as a result of a suit by a third party for alleged infringement brought against the manufacturer, may make a settlement payment in exchange for an ongoing license. The manufacturer would then be entitled to any returns it earned from the intangibles.

Among independent enterprises, an owner of intangible property who incurs risks and costs of R&D to create new intangibles is also entitled to intangible returns related to any future-developed intangibles. The owner's return isn't capped (for example, by a discount rate of return). MNE groups commonly hire independent enterprises to perform R&D services to create intangibles owned, and exploited by, the MNE group. In such situations the MNE group is entitled to returns attributable to the developed intangibles, independent of the degree of control exercised over the R&D service provider.

[22] The "more important functions" are listed in RDD, ¶ 79.

The language in paragraph 80 and associated paragraphs presumes or prescribes certain requirements for an intangible owner to be entitled to intangible related returns. As noted, these presumptions or prescriptions are inconsistent with situations among independent enterprises in which a legal owner of intangible property rights is entitled to intangible related returns. These presumptions or prescriptions are inconsistent with the directive under the arm's length principle that outcomes be determined based on the facts and circumstances of each case, using a thorough functional analysis.

As noted, the RDD—again prescribing an expected arm's length outcome—casts doubt on an intangible property owner's entitlement to intangible related returns if the owner outsources most or all of the putative "important functions" to other group members. The RDD goes further, warning that "in some such circumstances" the requirements allowing a tax administration to disregard the actual structure—without asserting that the substance of the transactions doesn't align with their form—may be present. Chapters I and IX of the TPGs warn that recharacterization on this basis is "generally is inappropriate," and must be made "with great caution" and "only in exceptional circumstances." These cautions should be injected into the discussion in section B, confirming that recharacterization is generally inappropriate.

C. ***Ex post*** **transfer pricing adjustments in the case of transfers of hard-to-value intangibles is inconsistent with the arm's length principle in Article 9.**

1. The arm's length principle is fundamental to Article 9(1) and must be applied *ex ante*.

As a legal matter, courts generally require independent enterprises to abide by the terms of written agreements governing the sale or license of intangible property. Independent enterprises don't generally get a chance to rewrite the terms of their agreements—they're stuck with the deal they've struck *ex ante*, based on the information then available. This is a corollary of the arm's length principle—the foundation of Article 9(1). The TPGs acknowledge that independent enterprises transacting "will ordinarily seek to hold each other to the terms of the contract, and . . . contractual terms will be ignored or modified only if it is in the interest of both parties."[23]

2. The Revised Discussion Draft in effect authorizes tax administrators to rewrite the payment form *ex post* for hard-to-value intangibles.

Subsection D.3 of the RDD—dealing with arm's length pricing for hard-to-value intangibles—draws attention to the BEPS Action Plan suggestion that one area for future BEPS related work is transfer pricing treatment of hard-to-value intangibles.[24] Cautioning that

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[23] TPGs, ¶ 1.53. *See also, e.g.*, TPGs, ¶¶ 2.128 and 2.130

[24] RDD, p. 47.

"substantial work" will be focused on this topic in coming months, the RDD transplants wholesale the discussion on hard-to-value intangibles from the existing TPGs.[25] The OECD should—during its consideration of hard-to-value intangibles—continue its longstanding practice of inviting public comment and consultation when important tax policy is at issue.

As a matter of fact, transfers of so-called hard-to-value intangibles, or rights in such intangibles, are commonplace among independent enterprises. This can't be seriously questioned. The rapid pace of innovation spawns growth in intangible property, and many products or services incorporate some intangibles transferred from third parties. Clearly one can't know with precision whether or when a licensee will fail or be wildly successful with its use of a transferred intangible. A contingent royalty payment form shares licensee upside reward with the licensor and shifts licensee downside risk to the licensor. It's not uncommon at arm's length for a licensor to set a two-stage royalty rate, in effect helping the licensor while it ramps up its business.

Conditioning its explanation in terms of what independent enterprises would have considered, the RDD asserts a price adjustment clause (e.g., a royalty rate increasing as sales increase) or a prospective renegotiation as examples of *ex post* adjustments a tax administration might pursue in transfers of hard-to-value intangibles.[26] These sorts of *ex post* adjustments are exceedingly rare among independent enterprises, and thus difficult to justify under the arm's length principle.[27] *Ex post* adjustments will also give rise to potential double taxation if one tax administration proposes such adjustments but a reciprocal tax administration follows the (*ex ante*) arm's length principle.

3. Any principled justification for permitting tax administrations to make *ex post* adjustments would equally justify such adjustments by taxpayers.

Although *ex post* adjustments are difficult to justify under the arm's length principle, the RDD suggests that such adjustments are only available to tax administrations, and not to associated enterprises who are parties to a transaction. If the controlling standard for making *ex post* adjustments to controlled transfers of intangibles is to follow "the arrangements that would have been made in comparable circumstances by independent enterprises," this avenue should also be open to associated enterprises. It shouldn't be a one-way street.

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[25] RDD, ¶¶ 199–206 are identical to ¶¶ 6.28–6.35 from the 2010 TPGs.

[26] RDD, ¶¶ 201 & 205.

[27] Making *ex post* adjustments to the terms of agreements among associated enterprises is akin to disregarding the structure adopted by associated enterprises entering a transaction. Paragraphs 1.64–1.65 of the TPGs caution that this latter action should only be taken in "exceptional cases."

D. Profit split methods shouldn't necessarily be preferred over transactional net margin methods

1. The RDD signals a preference for profit split methods—the determination of best method should continue to be based on the facts and circumstances.

The RDD properly acknowledges that not all intangibles transactions require complex valuations or the application of profit methods.[28] The RDD nonetheless signals a preference for profit split methods for determining proper pricing among members of a controlled group in the context of intangibles. For example, Section B paints a backdrop for the discussion on intangible related returns, explaining that "[t]he right of other members of the MNE group to receive compensation for their functions performed, assets used or contributed, and risks assumed may be conceptually framed as an allocation to those other members of all or part of the return attributable to the intangible."[29] The RDD shortly thereafter refers to "the ultimate allocation of the return attributable to the intangible."[30] After positing that in most cases the "important functions" described in paragraph [79] "are . . . essential to the creation of intangible value," the RDD cautions that "the reliability of a one-sided transfer-pricing method will be substantially reduced if the party performing the important functions is treated as the tested party."[31] In summarizing the discussion on functions, assets, and risks related to intangibles, the RDD asserts that if members of an MNE group other than the legal owner perform functions, use or contribute assets, or assume risks or costs related to the development, enhancement, maintenance, and protection of the intangible, "returns attributable to the intangible must accrue to such other members . . . ."[32]

Profit split methods can be useful. For example, a profit split method may be most appropriate in determining arm's length pricing for a license of an intangible if the licensee's profits are attributable both to the licensed intangible and to other intangible assets owned by the licensee. The determination of the most appropriate method must be made based on all the facts and circumstances, after a functional analysis is done.

The RDD shouldn't prescribe that the putative "important functions" are, in all cases, generally important and necessarily contribute to "the creation of intangible value;" nor should it thereby tacitly prescribe profit split methods for allocating profit away from the owner of an

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[28] RDD, ¶ 120.

[29] RDD, ¶ 65.

[30] *Id.*

[31] RDD, ¶ 81.

[32] RDD, ¶ 90.

intangible. The RDD shouldn't suggest that members of a multinational enterprise who perform functions, use assets, or assume risks related to intangible property are, in effect, engaged in a joint venture with the legal owner and must accordingly split profits with the owner.

Many arrangements exist between independent parties, governing the so-called "important functions" related to intangibles, in which service providers seek none of the profit properly earned by the legal owner of the intangibles. Patent aggregators with sufficient capital but virtually no assets other than intangible property buy patent portfolios and hire service providers to help enforce their patent rights against third parties. Companies hire third-party global R&D service providers to conduct R&D for them. MNEs hire third-party advertising agencies to develop global marketing and branding strategies. The RDD should remove the suggestion that a profit split will be the most appropriate method for determining payments to associated enterprises from the owner of intangibles. Each situation must turn on its unique facts and circumstances, which, after a functional analysis is done, drive the determination of the most appropriate transfer pricing method.

2. Recognition for the TNMM in the OECD TPGs should be endorsed

Paragraph 6.26 of the TPGs asserts that in cases involving "highly valuable" intangibles it might be difficult to find CUTs, and so

> [i]t therefore may be difficult to apply the traditional transaction methods and the transactional net margin method, particularly where both parties to the transaction own valuable intangible property or unique assets used in the transaction that distinguish the transaction from those of potential competitors.

Existing Chapter VI thus acknowledges (a) the possibility of using the TNMM in the context of intangibles, even perhaps high-value intangibles; and (b) that the TNMM is more likely to be appropriate in situations in which one of the parties to a transaction is performing only routine functions or using routine assets.

3. The 2008 *Report on Transactional Profit Methods* doesn't support eclipsing TNMM by profit split methods.

The 2008 *Report on Transactional Profit Methods* ("***2008 Report***") described general consensus among OECD member countries for using the TNMM to pressure test the outcome of another method used to derive an arm's length price for the transfer of an intangible.[33] The 2008 Report didn't, however, describe unanimous support for rejecting the use of the TNMM for setting or testing royalties—some countries endorsed the TNMM both to set and test a royalty.

[33] 2008 Report, ¶¶ 86–88.

Accordingly, the TNMM should generally be available to associated enterprises as a possible appropriate method for determining arm's length pricing in the context of intangibles.

Thank you in advance for your consideration of the above comments.

Respectfully yours,

Rod Donnelly

Rod Donnelly