COMMENTS RECEIVED ON PUBLIC DISCUSSION DRAFT

BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES

19 June 2015
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18/6/2015

TO: ANDREW HICKMAN
Head of the Transfer Pricing Unit
Centre for Tax Policy and Administration, OECD

SUBJECT: Observations to the OECD Discussion Draft on arm’s length pricing of intangibles when valuation is highly uncertain at the time of the transaction and special considerations for hard-to-value intangibles

Dear Mr. Hickman,

Firstly I would like to thank for the opportunity to share our thoughts regarding the OECD Discussion Draft on hard-to-value intangibles (HTVI-DD) released on June 4\textsuperscript{th}, 2015 and also congratulate this institution for the outstanding work and results developed in the subject of transfer pricing from the perspective of the BEPS project. As requested, I hereby provide a few comments regarding the guidance proposed by the OECD on matters related to intangible valuation issues in uncertain scenarios, which are rather specific and technical, although I consider them as appropriate for such a specified discussion topic. For the sake of clarity, I will structure them in two main categories. The first one regards the need for coherence between hard-to-value intangibles (HTVI) and recharacterization guidance. The second one reflects concerns regarding the interaction of HTVI guidance and domestic law.
Coherence between HTVI and recharacterization guidance as a tool towards the enhancement of certainty.

I shall start by posing the need to enhance certainty by means of cohesion in what regards transactional adjustments undertaken within related parties transactions, i.e. the modification of conditions other than prices or margins. The approach to HTVI supported by the OECD is an example of this kind of measures. Our first observation points towards the need to unify the criteria posed in the TPG (i.e. par.1.64 et seq.; par.9.168 et seq.), the new guidance present in the OECD BEPS Discussion Draft on revisions to Chapter I of the Transfer Pricing Guidelines (including risk, recharacterization and special measures) and the discussion draft on HTVI.

In this sense, we consider critical to recall the exceptionality criterion posed in par.1.64: “In other than exceptional cases, the tax administration should not disregard the actual transactions or substitute other transactions for them”. This point of departure is essential to maintain an appropriate level of certainty and to develop a reliable comparability analysis over a primary adjustment is based upon. Otherwise, tax administrations may wrongfully use transfer pricing rules as an orthodox anti avoidance measure, which is clearly not the purpose nor the role and function of the arm’s length standard. A less harmfulness approach should inform the whole recharacterization process, even when referred to HTVI problems. This somehow abstract approach may have a concrete impact in at least three aspects.

First, the delineation of circumstances that surrounds the transaction and parties concerned should be carefully and thoroughly handled, especially in what regards information asymmetries between *ex ante* and *ex post* perspectives. The HTVI-DD provides sensible criteria when stating that only “foreseeable and predictable” developments should be taken into account, leaving aside other circumstances that could not reasonably be anticipated by the parties. To provide otherwise would mean that the arm’s length principle is not being honored, as real-world independent parties will very rarely have all the relevant information before undertaking a transaction.

Notwithstanding this, also other factors should be taken into consideration, such as the bargaining power of each party and the urgency of gaining liquidity. In other words, there might be “foreseeable and predictable” indicators to require a different price to be ideally agreed, but other factors may point to a different outcome, e.g. due to the mentioned circumstances. The key consideration though would be to analyze whether independent parties would have reasonably agreed the same terms taking those circumstances into consideration. Again, from an exceptionality point of view, the “foreseeable and predictable” approach might run short in achieving that result. Hence, we respectfully ask the OECD to provide further guidance in this issue.
Second, due to the exceptionality criterion, the burden of the proof should always rest in the hands of the tax administration. As conducting a transactional adjustment is a last resort measure, the agent that tries to apply it should base its position on solid grounds. As guidance on this matter is insufficient, we encourage the OECD to deliver recommendations to enhance certainty thereupon. In this sense, the burden of proof should be distinguished from the taxpayers’ obligation to duly provide information to tax administrations in order for information asymmetries to be mitigated, i.e. stronger means to compile relevant information should be enforced. Departing from this background, criteria enshrined in par.14 HTVI-DD should be revisited. This paragraph states that if the taxpayer (1) provides sufficient information on \textit{ex ante} projections and (2) provides evidence to demonstrate that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated, then a comparison between \textit{ex-ante} projections and \textit{ex-post} outcomes should not be conducted by the tax administration. While this guideline may be labeled as a safe harbor for taxpayers –and thus has to be applauded for the sake of certainty- it may be interpreted \textit{a contrario} that taxpayers must bear the burden of the proof in what regards the revision of a HTVI buy-sell agreement remuneration. This line of thought should be criticized and the existence of that \textit{caveat} must be noticed. This is an outcome to be avoided and an explicit statement by the OECD in that direction may be welcomed.

Third, it is advisable to revisit the examples present along the OECD documents on transactional adjustments related issues, e.g. in par.90 of the OECD BEPS Discussion Draft on revisions to Chapter I of the Transfer Pricing Guidelines (including risk, recharacterization and special measures). This example basically regards the sale of the most valuable asset of an enterprise (an intangible asset) to a related party in exchange for a lump sum payment of $400 million. The buyer (S2) does not have the means to properly manage and exploit the intangible, and thus agrees on a services arrangement with the seller (S1). The discussion draft states that the alternative option of not entering into the transaction affords S1 greater opportunity to enhance or protect its commercial or financial position since it would retain the trademark key to its business.

The complete disregard of the transaction at hand should be regarded as disproportionate and does not abide by the notion of exceptionality, which should not be used only to define the scope of transactional adjustments but also the means to apply its consequence. Indeed, the solution posed in the HTVI-DD may be more adequate to approach the case. In this sense, to question the amount of the lump sum payment would a better technique to see whether independent parties would have agreed in the terms of the transaction. The first step to undertake should be to see whether the 400$
million payment is based on reasonable projections of anticipated benefits (par.2 HTVI-DD) and also whether the circumstances and the bargaining position of the seller may justify the sale of the asset (e.g. because it urgently needs liquidity). If not, there should be an analysis on whether some sort of a price adjustment clause should have been agreed to counter uncertainty at the time of valuation (par.3 HTVI-DD). In case the inclusion of this clause best suits the arm’s length principle in that regard, this is without doubt a preferable solution vis-à-vis the disregard of the buy-sell agreement, as it is more akin to a “less harmfulness” approach demanded by the exceptionality criterion.

The mentioned solution also avoids a considerable number of issues that arises in the event a complete disregard of the transaction is to be accomplished. Some of them were noticed in the comments submitted by myself and Prof. Dr. Juan Zornoza to the OECD regarding the Discussion Draft on revisions to Chapter I of the Transfer Pricing Guidelines (including risk, recharacterization and special measures), page 537, such as: should the revenue obtained by S2 derived from the exploitation of the intangible be attributed to S1? If yes, would be relevant to consider that S1 may have earned more revenue than S2 in exploiting the intangible? Could S1 deduct expenses in this regard? Should notional revenue be attributed to S1 in further fiscal years derived from a deemed exploitation of the intangible? If S2 sells the intangible from a private law perspective, should be considered this sale as undertaken by S1? If yes, should capital gains or losses be regarded as obtained by S1? We truly support that the HTVI approach avoids a fair amount of uncomfortable questions in this regard.

Comments regarding the interaction between HTVI guidance and domestic law.

Concerns in the field of the interaction between HTVI guidance posed by the OECD and domestic law parameters are to be divided in two categories.

First, the relationship between HTVI criteria regarded as part of the arm’s length principle itself with respect to domestic law targeted rules, e.g. the CWI standard present in US IRC section 482 or section 1(3), sentence 11 of the German Außensteuergesetz (Foreign Tax Code), poses relevant issues, being the most important one the existence of mismatches between HTVI-DD guidance and the design of these rules. An example of this situation could be the impossibility to develop downward adjustments by the taxpayer in the framework of these rules. Taking into account the “foreseeable and predictable” approach, ex post downward adjustments undertaken by the taxpayer may be justified. As the HTVI-DD guidance is based on the arm’s length principle, it is reasonable to infer that the OECD regards domestic mismatches as contrary to art.9.1 of the DTCs that follow the OECD-MC. All in all, in our opinion the
OECD should explicitly define its position to clear further doubts in this particular subject.

Second, the interaction between HTVI criteria and case law contrary to transactional adjustments should be clarified. In certain countries, such as the US, case law against the modification of controlled transactions’ conditions through transfer pricing rules may prevent tax administrations to approach the HTVI issue from the HTVI-DD standpoint. Since the Koppers case (Koppers Co. v. Commissioner, 2 T.C. 152 (1943)), the US so-called “could have” case law doctrine has impeded tax administrations to make assumptions on what could have happened had the controlled parties opted to structure the transaction in a different manner. Does the OECD regard as contrary to the arm’s length principle this line of case law? Has the OECD considered the impact of these kinds of unfavorable domestic law outcomes? More clarifications may be welcomed in this regard.

Respectfully submitted,

Yours sincerely,

Aitor Navarro Ibarrola
16 June 2015

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cc: Laura Beretta; Gianni Di Robertis

Re: Discussion draft on BEPS Action 8: hard-to-value intangibles

Dear Mr Hickman,

Federazione Nazionale Imprese Elettrotecniche ed Elettroniche ("ANIE") thanks the OECD for the opportunity to provide comments in response to the OECD Centre for Tax Policy and Administration’s Discussion Draft on Hard-to-value Intangibles (HTVI) (the "Discussion Draft").

ANIE greatly appreciates the work of OECD Working Party No. 6 on providing guidelines to ensure that transfer pricing outcomes are in line with value creation. This letter comments on certain aspects of the Discussion Draft and suggests areas for further enhancement and clarification. We hope that our comments may be useful in enhancing the effectiveness of the new proposed guidelines, in particular with regard to the practical issues that may arise in the transfer of HTVI.

General comments on hard-to-value intangibles

Frequency of adjustments

Financial projections used at the time of transactions between independent parties are imperfect and uncertain. It is often the different expectations of the seller and the buyer – reflected in different financial projections and discount rates – which create uncertainty about the value of the asset in a transaction between independent parties and make a transaction viable.
Despite this, in our experience, price adjustment clauses are relatively rare in agreements between independent parties. Therefore, as the purpose of the OECD Guidelines is to replicate what would happen between independent parties, the use of price adjustments by the tax authorities should not be frequent.

**Contribution of the buyer**
The Discussion Draft could acknowledge the fact that once an intangible asset is transferred from a seller to a buyer and the buyer starts managing and exploiting the asset, the subsequent value of the intangible asset may be significantly increased or decreased by the buyer’s use of it. This fact should be considered when analyzing differences between ex ante and ex post valuations of the intangible assets, as it would not be appropriate for the seller to receive (pay) a price adjustment for a value that has been created (destroyed) by the buyer.

**Symmetry of adjustments**
The implementation of the guidance proposed by the OECD would necessarily rely on certain subjective evaluations of what would represent "significant differences", "satisfactory evidence", "extraordinary events" etc., and this would increase uncertainty for taxpayers. In light of the above, it would be important that tax authorities respect price adjustment clauses used by taxpayers to reduce the uncertainty surrounding HTVI, regardless of whether they lead to an increase or a reduction in taxable income in a specific jurisdiction, in order to obtain symmetry of adjustments.

**Specific comments on the additional points indicated by the OECD**

1. **Comments are invited on whether there are mechanisms that could be adopted to provide greater certainty for taxpayers regarding the application of the approach to HTVI.**

- The Discussion Draft includes two examples of what may constitute satisfactory evidence of unforeseeable or extraordinary developments or events that occur after the determination of the price and that could not have been anticipated at the time of the transaction, e.g. "a natural disaster" and "unexpected bankruptcy of a competitor". We invite the OECD to consider providing additional examples.

- In order to reduce uncertainty, it might be appropriate to set a time limit on the comparison between ex ante financial projections and ex post outcomes or, at least, to discourage adjustments made many years after the original valuation. This would seem appropriate in light of the facts set out below:
  - price adjustment clauses agreed between independent parties generally have a relative short timeframe;
  - financial projections, by definition, tend to be less accurate the more they go into the future;
  - it is much less likely that developments and events in the more distant future can be known at the time of the pricing/valuation.
2. Comments are invited on whether any additional exemptions should be added to the exemption contained in paragraph 14 of this Discussion Draft. Where additional exemptions are proposed, commentators should explain how the exemption should be framed, considering the aims of the approach set out in the Discussion Draft.

The OECD could consider including an additional exemption, which would refer to the functions performed by the buyer of HTVI. For example, paragraph 14.3 could read as follows: "provides satisfactory evidence that part or all of the significant difference between the financial projections and actual outcomes is due to functions and activities which are performed by the buyer after the determination of the initial price, and which could not have been performed by the seller."

3. Comments are invited on whether the notion of "significant difference" in paragraph 13 should be defined, and, if so, what mechanisms could be used to determine whether a difference between the ex ante financial projections and the ex post financial outcomes is significant.

As a pragmatic measure to reduce the degree of uncertainty that could arise following the new guidelines, we invite the OECD to consider the possibility of including in the guidelines a threshold below which a difference between ex-ante and ex-post value would not be considered significant.

4. Comments are invited on what further matters would be useful to consider in any follow-up guidance on practical and consistent implementation of the approach.”

In terms of follow-up guidance, the OECD could consider monitoring the practical application of HTVI by both taxpayers and tax authorities, and provide specific examples of correct and incorrect application of the OECD guidelines. In addition, further guidance may be needed on how best to achieve symmetry of adjustments in relation to HTVI, within or outside the MAP process.

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We hope that the OECD will find our comments useful and that you will not hesitate to contact us should you wish to discuss the issues we have raised in this paper in more detail. For further information, please contact Laura Beretta [laura.beretta@prysmiangroup.com] and Gianni De Robertis [gianniderobertis@kstudioassociato.it], who have assisted ANIE in preparing this submission.

Yours sincerely,

[Signature]

Maria Antonietta Portolari
About ANIE

The Italian electrical engineering and electronics industry association (ANIE) is one of the major industry associations in Italy, representing electrical engineering and electronics companies. It was founded in 1945 and is a member of Confindustria. It has more than 1,200 members, with a combined workforce of 410,000 and a combined turnover of €56 billion at the end of 2013.

ANIE brings together very large multinationals as well as small and medium-sized Italian enterprises; 65% of its member enterprises have less than 50 employees. Its members place high importance on research and innovation and account for over 30% of private Italian investment in research and development.

Nationally and internationally, ANIE and its network of members seek to encourage and strengthen entrepreneurial values, promoting their development in pursuit of the general interests of the country and acting to ensure transparent rules. ANIE is part of the European Engineering Industries Association.
Buenos Aires, June 18, 2015

Mr. Andrew Hickman  
Head of Transfer Pricing Unit,  
Centre for Tax Policy and Administration  
OECD

E-mail Response: TransferPricing@oecd.org

RE: ASOCIACION ARGENTINA DE ESTUDIOS FISCALES (AAEF or Argentine Association of Tax Studies)  
RESPONSE TO THE OECD REQUEST FOR COMMENTS ON THE DISCUSSION DRAFT ON  
ARM’S LENGTH PRICING WHEN VALUATION IS HIGHLY UNCERTAIN AT THE TIME OF THE  
TRANSACTION AND SPECIAL CONSIDERATIONS FOR HARD-TO-VALUE INTANGIBLES (HTVI)

The Transfer Pricing working group of the Asociación Argentina de Estudios Fiscales (Argentine Association of Tax Studies – AAEF) is pleased to provide comments on the OECD’s paper on arm’s length pricing when valuation is highly uncertain at the time of the transaction and special considerations for hard-to-value intangibles (HTVI) related to Action 8 of the BEPS Action plan.

AAEF is a non-profit organization based in Argentina, whose active members are recognized tax experts from both the private and public sector. AAEF is the local branch of the International Fiscal Association.

We welcome the initiative to focus on topics as controversial as valuation of intangible property, while we consider that further work needs to be done to define in a more precise manner certain concepts and/or situations analysed by the Draft. Moreover, we have some concerns on how the measures proposed could be misunderstood and how to rephrase the wording to clearly prevent hindsight.

1 Created in 1953, the Argentine Association of Tax Studies committed itself in its 61 years to promote research on Fiscal Law and related disciplines among its members, Law and Economic Sciences professionals graduated from any of the Argentine Universities.

2 Created in 1953, the Argentine Association of Tax Studies committed itself in its 61 years to promote research on Fiscal Law and related disciplines among its members.
Our comments refer to five aspects of the discussion:

- Information asymmetries and how to deal with them
- Developments subsequent to the transfer
- How to prove non-existent events
- Definitional issues, and
- Statute of limitation

In the following, we have elaborated on each of the above:

**Information asymmetries and how to deal with them:**

From the Draft, it could be inferred that the issue that the tax authorities would like to tackle is the lack of information and “how to solve the information asymmetry between the taxpayer and the tax administration”. Paragraph 6 states that “The difference between the ex-ante and ex-post value of the intangible would therefore be claimed by the taxpayer to be attributable to more favourable developments than anticipated”, and goes on to say that the tax administrations in these situations “...may not have the specific business insights or access to the information to be able to examine the taxpayer’s claim and to demonstrate that the difference between the ex-ante and ex-post value of the intangible is due to mispricing by the taxpayer.”

Being so, we wonder why the Draft does not focus directly on the issue at hand, but creates an indirect way to approach the problem by analysing the differences that might result by comparing the ex-ante vs. ex-post results. In our opinion the proposed methodology moves away from the arm’s length standard and leaves significant room for an arbitrary use of hindsight and, thus, for dispute and double taxation.

The chosen approach has a number of side-effects – which later will be commented on – that could have been avoided by simply tackling the matter, this is, the tax authorities information needs to control the taxpayers’ estimates at the moment of the transaction considering the data available at that moment.

A detailed definition of the documentation to be gathered by the taxpayer in order to be considered sufficient proof of the events known or predictable at the moment of the transaction, filing such information contemporaneously with the transaction, involving independent industry experts in the analysis and/or requiring a mandatory APA are tools that, among others, would help...
in levelling the playing field and significantly mitigate the asymmetries of information between the tax authorities and taxpayers. Moreover, it is important to remember that the new documentation approach (i.e. master file, local file and country by country report) contains special requirement for transactions involving intangible property which will provide the tax authorities with information to assess the transaction at the moment (or close to) when the transaction is taking place.

**Developments subsequent to the transfer**

Development, enhancement, maintenance, protection and exploitation functions are of the essence of an intangible property transfer pricing analysis. It is worth noting that deviations from ex-ante vs. ex-post results might arise due to the subsequent developments carried out by the intangible purchaser. In our opinion, the Draft’s wording should be expanded to consider these kinds of events.

**How to prove non-existent events:**

The proposed approach, that is, comparing ex-post and ex-ante information not only could be used as hindsight and the chance for the tax administration to assess valuations of intangibles with information that the taxpayer didn’t know or couldn’t predict at the time of the transfer, but also puts the taxpayer in a position of impossible compliance. How can a taxpayer prove a true lack of knowledge of the events and developments taking place and/or predictable at the time of the transfer? The general rule is that I can prove that I knew something, but how can I prove that I really did not know a fact? An example could be illustrated with the case described in paragraph 15 in relation to the bankruptcy of a competitor. Let’s assume that the taxpayer was not aware of this (potential) event or could not predict it. How could the taxpayer prove his or her lack of knowledge, if the tax authorities argue that due to information supposedly available at that moment, he or she should have known these facts and considered them a possibility?

**Definitional issues:**

The definition of HTVI is another potential point of conflict. Definition of HTVI in paragraph 9 is too ambiguous and leaves room to characterize almost all of the transactions involving intangible property as HTVI. Additionally, paragraph 10 defines HTVI, for which a new valuation approach has been proposed, considering ex-post “unpredictable” events or developments.

However, when defining HTVI, the following comments / questions arise:
- Would a 10%-developed HTVI be considered as equal with a 90%-developed HTVI?
- What does “intangibles that are partially developed at the time of the transfer” mean? A brand could be considered to be fully developed but a future event after the transfer (e.g. a slight change in the design, its use in a different product, etc.) modifies such brand. Will it be considered to be “partially developed” at the moment of the transfer?
- What does a “novel manner to be exploited” mean? A product extension of a well-known trade mark could be considered novel?

**Statute of limitation:**

Lastly, a conflict with the statute of limitation rules could be anticipated. On the one hand, the ex-post approach could be ineffective if the transfer of the intangible or the rights in the intangible took place several years before the ex-post vs. ex-ante difference had been detected and challenged by the tax authorities. In this case, the taxpayer could argue that the transaction took place in a fiscal year that is already statute barred. On the other hand, if it were understood that the proposed adjustment to the transaction price is an event contemporaneous with the fiscal year when the tax authorities detect and determine the price difference, then these kinds of transactions would never be statute barred. This conflict could be solved by dealing with the issue when it takes place, i.e. providing the tax authorities with enough documentation to mitigate the information asymmetries just when the transaction is taking place.

Should you have any inquiries or doubts, please do not hesitate to contact us at the e-mail addresses below.

Sincerely,

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OECD Discussion Draft under BEPS Action 8 on Hard-to-Value Intangibles (the “Discussion Draft”)

We welcome the opportunity to comment on the OECD’s discussion draft on hard-to-value intangibles (“HTVIs”), as issued on 4 June 2015. We are pleased to contribute our comments below.

General comments

We firmly believe that any “special considerations” proposed in the Discussion Draft, should only apply after every effort has been made to test a transaction as contracted by reference to functionality, risk and comparability. In our view, the vast majority of transactions involving HTVIs should be capable of being tested by reference to a functional analysis in order to ensure adherence to the arm’s length principle. Furthermore, we consider that intra-group deals should be structured in the same way as external transactions, even on a single set of assumptions, in order to deal with uncertainty. Accordingly, special considerations should only be applied in exceptional circumstances where a transaction lacks the fundamental economic attributes of arrangements between unrelated parties.

We agree that the approach outlined in the Discussion Draft should only be applied where the difference between the valuation based on the ex post outcomes and the valuation based on the ex ante projections is significant, to avoid unnecessary challenges and audits by the tax administrations and the associated compliance costs. Further guidance of the term “significant” would be helpful, but we do not believe that a definition of the term by reference to any fixed percentage of variation would be particularly helpful for the pharmaceutical sector, given the volatility of assets in our industry.

Specific comments

In our view, the notion of “significant difference” in paragraph 13 of the guidance should not be defined by reference to any fixed percentage of variation. Given the relative volatility of assets in our industry, we believe such an objective approach would be very difficult to implement across multiple industries and could lead to numerous tax audits and disputes which would increase the administrative burden and associated compliance costs.

We support the proposal set out in the first section of the paragraph 14 exemption, whereby the taxpayer has a responsibility to provide full details of its ex ante projections to support the transaction, thereby ensuring symmetry of information between taxpayer and tax administration. However, we recommend that the second part of paragraph 14 should be broadened to allow for situations where significant differences arise as a result of deviations in the original assumptions as well as from unanticipated events. As currently written, to meet the exemption, any significant differences between the financial
projections and actual outcomes must be due to “unforeseeable or extraordinary developments or events”. The example in paragraph 15 cites “natural disaster” and “bankruptcy of a competitor” as events which might fall within this category; these types of events are in our view too remote and too narrow to allow for deviations in the ordinary course of business.

In the pharmaceutical industry, independent enterprises routinely enter into deals which relate to products still in development involving significant uncertainty and risk. The relevant economic benefits and risks are understood by the parties and deals are structured to share the risk and reward between the two parties, with each side effectively hedging against the intangible performing badly or very well, for example via the use of a contingent payment structure. Notwithstanding the contract structure, significant differences will still arise between the financial projections and the actual outcomes. Such variations in the original assumptions are normal and inevitable given the long time horizons for development and commercialisation of a pharmaceutical product and, in the vast majority of cases, such significant difference do not result in renegotiation of the terms of the contract. We recommend, therefore, that the threshold set out in the second test should be lower and, provided the taxpayer can offer rational explanations for the deviation from original assumptions, the transaction should not be subject to any special considerations. This should particularly be the case where (i) neither of the parties to the arrangement are low functioning entities in low or zero tax jurisdictions; or (ii) where there is an expected incremental pre-tax economic benefit to the group as a result of the transaction; or (iii) there are other commercial or non-tax justifications for the transfer e.g. the transaction is intended to achieve an alignment with economic value-adding activities.

In circumstances where special considerations are required, ex post financial data should be used as a pointer only, and not as a basis for adjustment by the tax authorities. We recommend that further guidance is included on how the price will be adjusted; it is currently unclear on how the tax administrations will determine what would have been the alternative, hypothetical pricing arrangement.

Finally, the guidance seems geared to situations where the asset being transferred is more successful than anticipated. There needs to be some explicit reference in the guidelines to symmetry of treatment that ensures that downwards adjustments are also possible where, for example, a product is less successful than anticipated or even fails.

**Further matters for consideration**

We strongly believe that taxpayers should not be taxed more than once on the same profit. Therefore, we feel that significantly more guidance should be provided in relation to the mechanics of an effective system of double tax relief and dispute resolution, in order to help avoid the potential disputes with multi-country implications that could arise.

Furthermore, we recommend that further consideration is given to the extent to which measures resulting from revisions to other Chapters of the Transfer Pricing Guidelines (e.g. Chapters I and VI) might interact with the proposals in the Discussion Draft and further clarity around this – perhaps in the form of a hierarchy - would be welcomed. This would also help to ensure the narrow application of special considerations to only target egregious arrangements that aren’t dealt with elsewhere in the Transfer Pricing Guidelines and which, in turn, should help to manage the administrative burden and compliance costs for taxpayers and tax authorities.
This is notwithstanding the possible impact of the work being done under other BEPS Actions (e.g. interest deductions, CFC rules and anti-hybrid rules) as part of a holistic reconciliation. The risk of overlap and confusion is a concern, and the result could lead to multiple incidence of taxation if there is no clear consensus as to where profits should be taxed. Accordingly, we recommend that considerations with regard to implementation take into account the interaction of measures resulting from the other BEPS Actions.

We appreciate the opportunity to submit our views on the subject. Should you wish to discuss our response further in a meeting or on a call then please do not hesitate to contact me.

Yours sincerely

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**BEPS Action 8: Hard-to-Value Intangibles**

Dear Mr. Hickman,

BDI* refers to the OECD Discussion Draft “Hard-to-Value Intangibles” issued on 4 June 2015. We would like to thank you for the possibility to provide our comments that allow us to engage with you on these important issues. However, we would like to note that the two weeks’ time frame for comments is rather unfortunate and poses a significant challenge. We have limited our comments to some general issues of the Draft.

- Without doubt all guidance on Transfer Pricing need to be driven by the arm’s length principle. Considering this, there is some doubt that unrelated parties would habitually accept mechanisms that provide for adjustments of the original acquisition price several years after the transfer has taken place. The discussion draft takes the opposite view, however, does not provide any underlying empirical data for this hypothesis. Insofar we believe that the discussion draft is built upon an unproved assumption on independent parties’ behaviors in business transactions. It therefore it seems to be lacking a sound conceptual starting point.

- According to para. 14 of the discussion draft, an ex-post price adjustment could be avoided if the taxpayer “provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.” However, we believe that the

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* BDI (Federation of German Industries) is the umbrella organization of German industry and industry-related service providers. It speaks on behalf of 36 sector associations and represents over 100,000 large, medium-sized and small enterprises with more than eight million employees. A third of German gross domestic product (GDP) is generated by German industry and industry-related service.
According to para. 9 et seq. of the discussion draft, the term hard-to-value-intangible (HTVI) would cover “intangibles or rights in intangibles for which, at the time of their transfer in a transaction between associated enterprises, (i) no sufficient reliable comparable exist, and (ii) there is a lack of reliable projections of future cashflows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain”. From our perspective, this definition is flawed. Firstly, the definition refers to extremely interpretable and hence disputable criteria such as “sufficient reliable”, “reliable projections”, “highly uncertain”, without providing any specification. Secondly, it lies in the nature of most intangibles, that they are unique, i.e. not comparable to each other. Consequently, the number of reliable comparables is per se limited. Also, it is typical for most intangibles, that they generate future income streams, which are uncertain and therefore based on a set of assumptions. From that perspective, the definition does not describe the specifics of a separate category of intangibles, namely HTVI, but standard features that many intangibles have in common. Consequently, it might be assumed that numerous intangibles – and not only specific intangibles – would fall under the new HTVI-definition. The impact of the HTVI-definition would be much broader than actually intended. It should be recalled, however, that the goal of action 8 – HTVI is the development of specific measures for specific intangibles. The overly broad HTVI-definition contradicts this goal.

Furthermore, we disagree with the “features” of HTVI as listed in para. 10. While we understand that the transfer of partially developed (at the time of the transfer) intangibles (first bullet) implies a certain risk for the tax authorities, we do not see the necessity to expand the definition of a HTVI to those intangibles which are “connected with the development of enhancement of other intangibles which fall within the category of HTVI” (third bullet). With other words, a HTVI might “infect” all those other intangibles to which a “connection” exists (connection through infection theory). This approach seems to be overly strict. Also, we fail to see the abusive element of intangibles “that are anticipated to be exploited in a manner that is novel at the time of the transfer”. However, we believe that such an approach might discourage MNEs from developing new, innovative business models. With regard to the third bullet (“intangibles that are not anticipated to be exploited commercially until several years”), it is unclear which kind of tax planning structures are specifically addressed.

In addition to the above we fear that the use of certain terms without providing further guidance or definitions, for tax payers and tax administrations alike, may result in an increasing number of double taxation situations. This would e.g. include; "sufficiently reliable comparables” (para 9), “lack of reliable projections of future cash flows or income”, ”significant” (para 13), ”satisfactory” (para 14, 15), ”should have been foreseeable" (para 13), "full details" (para 14),
"reasonable foreseeable events" (para 14). Also, in order to avoid the risks for disputes and disproportionately increase the compliance burden for MNE, the Draft should focus on the development of the Transfer Pricing Guidelines as such and not on the introduction of unclear “special measures” which go beyond the arm’s length principle.

- It must be further clarified that special measures like price adjustment mechanisms are only applicable in exceptional limited cases. From a taxpayer’s perspective, it is also highly problematic that the draft does not define the relevant adjustment period or any milestones or end dates (in years), as from which the perspective would switch from “ex ante” to “ex post”. If a transfer of a HTVI takes place, the “ex post” phase is already reached one logical second after the completion of the transfer. The missing definition of the relevant adjustment period leads to significant legal uncertainties for the taxpayers. If the transfer of a HTVI takes place in period t=0, tax authorities could e.g. claim an adjustment of the original transfer price in t=2, but they could theoretically also do so in e.g. t=20. The timeframe within which retrospective adjustment could be possible should be strictly limited and specified in the guidance. We would consider a maximum period of 2 years starting from the transfer of the HTVI as a reasonable time window for tax authorities to claim potential adjustments. The possibility of tax administrations to arbitrarily apply the HTVI regulations ex-post must be limited as much as possible to provide legal certainty for taxpayers and to minimize double taxation risks. It should not be used as an avenue by tax administrations to unduly penalise taxpayers who do not have the benefit of hindsight at the point of valuing the intangible / HTVI.

Please do not hesitate to contact us if you have any questions.

Sincerely,

Berthold Welling

Dr. Karoline Kampermann
BEPS MONITORING GROUP
Discussion Draft for BEPS Action 8: Hard-to-Value Intangibles

This response is submitted by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. This paper has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives.

This paper has been prepared by Jeffery Kadet and Sol Picciotto, with comments and input from Veronica Grondona.

We welcome this opportunity to comment on this Discussion Draft (DD), and to participate in the public consultation.

SUMMARY

The transfer of intangible property rights to related entities is one of the main techniques used by multinational enterprises (MNEs) to avoid taxes through base erosion and profit shifting (BEPS). Such assets are especially hard to value if they are transferred at an early stage, since their income-generating potential will be speculative, although best known to the firm itself. This discussion draft (DD) proposes that, in specific circumstances, the price of the asset transfer can be adjusted subsequently by tax authorities, taking into account the income actually generated. However, the DD specifies a number of conditions which must apply for this approach to be adopted.

Although desirable, in our view the proposals do not go far enough in two respects. First, the mechanism adopted should itself discourage transfers taking advantage of ex ante pricing, which is where most BEPS concerns and risk arise. Second, the DD must aim to reduce the endemic and serious problem of information asymmetry between a tax authority and a company. This is rooted in the requirement under the arm’s length principle to evaluate internal transfers within a firm, since the tax authority can never know a firm’s business better than the firm does.

Hence, we suggest instead a reversal of the burden of proof, with a presumption that any intra-firm transfer of HTVIs should be subject to pricing based on subsequent consideration of the actual income produced, unless the taxpayer can show that specified criteria were satisfied. We also propose two additional criteria for such a showing: proof that the transfer did not result in a significantly lower effective tax rate, and a ‘purpose test’ requiring satisfactory evidence of the legal and commercial reasons for the transfer. This reversal of the burden of proof will create a much stronger incentive for firms to cease tax-motivated transfers of intangibles. In addition, to provide more certainty, we suggest an APA-like ruling process.

GENERAL COMMENTS

The transfer of intangible property rights to related entities is one of the main techniques used by multinational enterprises (MNEs) to avoid taxes through base erosion and profit shifting (BEPS). The initial development of such intangible assets usually requires large upfront investments which are essentially sunk costs, although they can usually be treated as tax deductible. If such assets can be transferred to an affiliate holding company formed in a suitable jurisdiction, their use can be licensed to operating company affiliates in foreign
countries, resulting in tax-deductible royalty payments. This income can be routed through another affiliate, acting as a conduit to reduce or eliminate withholding taxes in the source country, resulting in totally tax-free earnings accumulated in the cash-box asset holding company.

Tax authorities have the power to challenge such profit-shifting, but under the separate entity principle they are expected to do so by requiring that the price paid on the initial transfer of such assets is comparable with the price that would have been paid by independent parties transacting at ‘arm’s length’. If the assets are transferred before they begin to generate significant profit, this price will necessarily be quite low, since the income-generating potential of the assets will be speculative. It is difficult for a tax authority to challenge a low valuation based on comparables, as it will know far less than the company about this potential value (asymmetric knowledge). Hence, these can be described as hard to value intangibles (HTVI).  

Even more importantly, the MNE has nothing to lose by the transfer, since it is not a true sale to an independent entity which could be a potential competitor, but only a paper transfer to an affiliate within the group. MNEs today are generally centrally managed, controlled, and coordinated organizations that act as a unity. They are not independent and separate business units that all just happen to have some common ownership. Their explanations for making HTVI transfers from one entity to another are normally simply efforts to put a non-tax-motivated gloss on the relevant transfers. The typically stated motivation for the transfer, for example for the efficiencies of centralized management of IP, is mere window dressing.

For these reasons, in our view the application of the arm’s length principle is inappropriate in these circumstances. To deal with this, the discussion draft (DD) proposes that, in specific circumstances, the price of the asset transfer can be adjusted subsequently (ex post), and can take into account the income actually generated. However, the DD specifies a number of conditions which must apply for this approach to be adopted, in particular (i) that independent enterprises would have included a price adjustment clause in the contract, or that the subsequent developments would have led them to renegotiate the terms (para. 5), and (ii) that the intangibles have characteristics that make them hard to value, such as those listed in DD para. 10. It also specifically excludes application of the approach if the company

1. provides full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks, and

2. provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not

The only other practical approach that tax authorities have within this ‘separate entity’ principle is to attempt to re-characterise the form that the taxpayer has chosen. A recent example of this approach is the attempt by the U.S. Internal Revenue Service to reverse the benefits of certain BEPS structuring conducted by Caterpillar Inc. over the last 15 years. This effort by the IRS was disclosed in certain regulatory filings made by Caterpillar earlier this year. While ‘practical’, such re-characterisation efforts have typically been uncertain of success; they’re almost a toss-up. Such disputes will often become the subject of litigation with court decisions sometimes sustaining the relevant tax authority and sometimes the taxpayer’s position.
have been anticipated by the associated enterprises at the time of the transaction. (Para. 14).

We entirely agree that, if the aim is to establish an appropriate price for the transfer, this is the right and appropriate guidance. In our view, however, it is necessary to begin with different assumptions. Our honest perception is that many, if not the vast majority, of related party transfers of HTVIs either are motivated by BEPS objectives or, at a minimum, carry significant BEPS risks for the governments concerned. The approach adopted in the DD will make this a little more difficult for MNEs, by requiring them to produce documentation and analyses demonstrating calculations of projections and evaluations of risk. This will entail more work for their legions of advisers, who will no doubt earn substantial fees. The trouble and expense involved will very likely deter some, especially smaller MNEs from continuing with such structures. However, for the rules to be effective, tax authorities will also need to make substantial investments of time for skilled specialists to analyze and evaluate the documentation provided by companies, to substantiate a challenge. Even as well-resourced an authority as the United States Internal Revenue Service recently had to engage outside advisers at a reported cost of $2m to assist with an audit of Microsoft. It would be very hard for smaller tax authorities, especially in developing countries, to apply the resources necessary to make these rules effective.

Considering today’s environment where the bulk of intra-group HTVI transfers, especially those conducted on an ex ante basis, will have BEPS motivation and/or risk, we suggest that any transfer within a MNE group on an ex ante pricing basis should be presumed to have potential BEPS consequences unless established otherwise. If not established otherwise, then an ex post commensurate with income concept would be applied to attribute appropriate levels of actual profit in the hands of the transferor and transferee.

The conditions stated in para. 14 cited above are of course very appropriate. However, under the approach we are suggesting, they are not conditions that prevent a tax authority’s actions. Rather, they should be conditions to be satisfied by the taxpayer to override the presumption that any intra-group transfer of an HTVI should be measured solely on an ex post commensurate with income concept to place appropriate levels of future profit in the hands of the transferor and transferee.

This approach, in contrast to that suggested in the Discussion Draft, will encourage MNEs to adopt ex post pricing approaches for any transfers of HTVI that have truly been conducted for legitimate legal and commercial purposes. What is suggested in the Discussion Draft will only encourage more ex ante pricing with the high expectation of the MNEs that tax authorities will have little ability to understand and actually object to the complicated detailed description and evidence of differences.

**Specific Comments**

1. **Comments are invited on whether there are mechanisms that could be adopted to provide greater certainty for taxpayers regarding the application of the approach to HTVI.**

We suggest adoption of a ruling procedure along the lines of those used for APAs to provide for bilateral approval of the formula or other mechanism that will be applied on an ex post basis to attribute an appropriate level of profit. This should operate in conjunction with the presumption, described in the previous section, that any related party transfer of a HTVI should be subject to ex post price adjustment, unless the taxpayer can justify the ex ante pricing.
2. Comments are invited on whether any additional exemptions should be added to the exemption contained in paragraph 14 of this Discussion Draft. Where additional exemptions are proposed, commentators should explain how the exemption should be framed, considering the aims of the approach set out in the Discussion Draft.

As indicated earlier, we have suggested that any transfer of an HTVI on an ex ante basis be presumed to have potential BEPS consequences unless established otherwise. If not established otherwise, then an ex post commensurate with income concept should apply to place an appropriate level of actual profit in the hands of the transferor.

If our suggested presumption approach is not adopted, then we suggest the following additional conditions that should be added to paragraph 14:

3. provides satisfactory evidence that the income recognized in the hands of the transferee (including any indirect transferee due to any further transfer, license, or other effective disposition of the HTVI or any portion of it) has been subjected to an effective tax rate that is no less than 95% of the rate at which the relevant income would have been taxed in the hands of the transferor had the transfer of the HTVI not taken place;

4. provides satisfactory evidence of the legal and commercial reasons behind the business decision to make the HTVI transfer.

If our presumption approach is adopted, then these additional suggestions should be included as being helpful to any effort a taxpayer chooses to make to overcome the presumption.

3. Comments are invited on whether the notion of “significant difference” in paragraph 13 should be defined, and, if so, what mechanisms could be used to determine whether a difference between the ex ante financial projections and the ex post financial outcomes is significant.

We believe that ‘significant’ should be defined as the lesser of both a percentage difference and an absolute amount of difference. For example, it could be defined as the lesser of (i) 20% of the median financial projection and (ii) Euros 1 million. Larger developed countries might of course choose to place the absolute amount at Euros 10 million or some other number. For many countries in this world, the lower suggested amount is very material.

4. Comments are invited on what further matters would be useful to consider in any follow-up guidance on practical and consistent implementation of the approach.

Unfortunately, the discussion in this Discussion Draft is a painful reminder of how wide the chasm is between the knowledge, control and power of the average MNE and that of the average tax authority in dealing with a HTVI. The fact that, as mentioned above, even the heavily-resourced and highly sophisticated U.S. Internal Revenue Service is fighting with Microsoft about the IRS’s hiring an outside consultant to help it with transfer pricing issues is testament to this. Tax authorities simply do not have the required internal knowledge or resources to understand a company’s business as well as the company itself does. The efforts that Microsoft has been making to disqualify the consultant from participating in the audit demonstrates how much such firms value their superiority of technical resources. The requirement under the arm’s length principle to evaluate internal transfers within a firm means that a tax administration will always be at a disadvantage attempting to apply it.

Clearly, for the reasonable administration of tax systems, the mechanics of the systems themselves must encourage taxpayers to act based on non-tax factors and not be encouraged to create BEPS structures. Creating as a mechanism a presumption, as we have suggested, that will discourage transfers on an ex ante basis, along with a ruling procedure for splitting
the ex post results, could significantly reduce BEPS-motivated HTVI transfers and reduce as well the need for taxpayers and tax authorities to review such transfers. Where there have been legitimate legal and commercial reasons for a transfer, then a taxpayer should spend relatively little effort to secure a ruling for the ex post split of the results.

This Discussion Draft is a powerful statement for the benefits of the expanded use of the profit split method. In prior comment letters, we have recommended that guidance be provided for specific concrete allocation keys for all common business models along with a clear statement of the principles involved so that allocation keys can be determined as new business models are developed. With such use of the profit split method, the intractable issues raised in this Discussion Draft could be completely sidestepped.
BIAC thanks the OECD for the opportunity to provide comments on its Discussion Draft on Action 8 (Hard-to-Value Intangibles – HTVI) of the Base Erosion and Profit Shifting (BEPS) Action Plan issued 4 June 2015 (the Discussion Draft). This is a very important subject.

As you yourself must be only too aware, the timeline for this consultation has been very short! In an effort, therefore, to further assist with clarity and to provide a fuller discussion of key points, BIAC will continue consulting with its members until the date of the public consultation. We will collect practical examples of arm’s length dealings, and practical issues that are anticipated for the implementation of the proposed new guidance and, if these appear illuminating, will raise those additional comments or examples during the discussion at the public consultation.

BIAC interprets the structure developed by the OECD in the Discussion Draft as a welcome effort to provide a clear framework for taxpayers and tax authorities. However, BIAC observes that the subject is very complex and significant risk of diverging interpretations exist. We have, therefore, focussed on trying to clarify the scenarios in the Discussion Draft.

We are concerned that the special measures for HTVI only be used in exceptional circumstances where arm’s length pricing clearly has not worked. We suggest that the OECD recommend a proportionate approach to tax authorities in the adoption and implementation of such new rules. It will also be important to monitor how the new guidance will be implemented, and BIAC is available to support initiatives in that direction.

This letter is organized into two sections: an executive summary, followed by detailed comments sequentially following the structure of the discussion draft. Again, we thank you for the opportunity to comment, and stand ready to help further in any way that we can.

Sincerely,

Will Morris,
Chair, BIAC Tax Committee
EXECUTIVE SUMMARY

Given the short timeframe available for reviews, this executive summary is organized in the form of bullet points, which summarize the arguments developed in the detailed comments.

- A special measure within the arm’s length principle (ALP) should be limited in scope to representing a rebuttable presumption, allowing taxpayers to bring any type of evidence to support the arm’s length nature of the transaction that is being challenged. Special measures should, by nature, be applicable only in exceptional cases.
- Paragraph 4 of the discussion draft refers to the fact that “independent enterprises may determine to bear the risk of unpredictable subsequent developments”: the concept should be further developed in order to acknowledge that in arm’s length dealings it is possible to transfer risk “without recourse” and that multinational groups can routinely centralize IP without constantly revisiting the outcomes.
- Where an intangible did not have the nature of HTVI at the time of transfer, it should be recognized that ex-ante projections cannot be required.
- The timeframe within which retrospective adjustment could be possible should be strictly limited and specified in the guidance.
- Additional exemptions are recommended in relation to the following cases:
  o HTVI’s priced indirectly using one sided methods based on sufficiently reliable comparables;
  o HTVI’s for which a profit split method has been adopted reflecting the HTVI uncertainties within the profit split mechanism itself;
  o HTVI’s which did not have the nature of HTVI at the time of transfer;
  o HTVI’s for which the probability of unforeseeable and extraordinary events was very low; and
  o HTVI’s whose value remains hard to value also ex-post (e.g. because they are part of a more complex product).
- The proposed guidance should only apply in case of very significant divergences between ex-ante and ex-post results.
- A special measure should apply only to prices set after its introduction.
- Global consensus on offsetting adjustments should be developed.
- Independent parties are more likely to modify pricing prospectively rather than retroactively.

DETAILED COMMENTS

Introduction

1. Within the discussion draft’s introductory paragraphs it is stated that “The approach protects tax administrations against the negative effects of information asymmetry when specific conditions are met.”

2. The “approach” therefore apparently introduces a “special measure” but it is not fully clear whether this special measure would overcome the arm’s length principle (ALP) and how. In fact, the ALP seems to be preserved considering the (immediately) following sentence in the discussion draft, which we welcome: “These conditions ensure that price adjustments will only apply where the difference between expected and actual outcomes cannot be explained by considerations other than inappropriate pricing”.

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3. The fact that the ALP should be respected is also supported by the principle statement in paragraph 1, discussed below. BIAC would strongly support this interpretation and recommends that the OECD develop more clarity about how the approach should be applied; for example, if the ALP is to be respected, a logical consequence could be to consider the “approach” to represent a presumption that tax authorities can develop in certain specific cases defined by the “approach”, but such presumption should be fully rebuttable, i.e. the taxpayers should be allowed to bring any type of (reliable) evidence, either of an ex-ante or an ex-post nature, to support the arm’s length nature of the transaction that is being challenged.

4. More generally, re-valuations based on ex-post information do not appear to be frequent in dealings between independent parties, while the current wording of the discussion draft appears to be broad and open to widespread application of this special measure to many situations, rather than only in exceptional circumstances.

Paragraph 1
5. At the very beginning of paragraph 1 there is a reference to “whether the guidance on non-recognition applies” which gives the impression of supporting non-recognition instead of considering it an exceptional circumstance. BIAC would recommend keeping the simple reference to section D of Chapter I as an adequate reminder (implicitly including all aspects discussed in that section).

6. Paragraph 1 also states the principle that: “The question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in the pricing of the transaction.” BIAC fully agrees with this principle, which serves to confirm the prevalence of the ALP in the practical application of the “approach”. However, BIAC is concerned about the risk that some of the detailed guidance in the draft could be interpreted as partially departing from this principle, and this drives the BIAC comments and recommendations included above in the comments related to the introduction.

Paragraph 4
7. Paragraph 4 refers to the fact that “independent enterprises may determine to bear the risk of unpredictable subsequent developments”. BIAC considers the outcome of the example based on a royalty rate for the transfer of rights in intangibles to be appropriate. It should be noted that different results are likely to be appropriate in the case of transfer of an intangible and BIAC considers that the concept should be further developed in order to acknowledge that independent enterprises may determine to transfer risk “without recourse”, i.e. to trade-off the risks of uncertain future developments with a fair remuneration of the value created until the time of transfer of the intangible.

8. Two typical cases in which intra-group transfer of risk may occur are those where:

   a. Certain IP developments are too risky to leave the uncertainties of their economic outcome on specific individual entities; or

   b. A multinational Group is growing by acquisitions: in such cases there is often a strong business need to centralize IP in order to manage it efficiently (it should also be
noted that, in such cases, denying the economic consequences of risk centralization would raise issues going well beyond transfer pricing, because it would in fact imply not recognizing one of the purposes of the arm’s length acquisition, whose “non-recognition” could not be enforced vis-à-vis the independent seller).

c. Though these are typical situations, there might be various other examples in which such an intra-group transfer of risk occurs.

9. In relation to the points above, BIAC recommends to approach cases where a multinational group has adopted IP centralization policies by focusing on the arm’s length nature of the policy and whether or not it is applied consistently: in these cases, focusing on individual transactions would be a likely source of double taxation and conflicts among taxing authorities. Furthermore, focus should be equally on successful as well as unsuccessful transfers.

10. BIAC understands that there may be concerns in relation to the fact that IP could be centralized in tax havens. However, that issue appears to be addressed by other BEPS action items and BIAC encourages the OECD to recognize that a group can routinely centralize IP.

Paragraph 9

11. BIAC recommends to expand the concept of “reliable comparables”, considering that literally this seems to apply only when comparables are searched in order to directly assess the price of the transfer of intangibles or right in intangibles. Nevertheless, BIAC observes that comparables are routinely used to indirectly set the price of intangibles using one-sided-methods (such as the TNMM), in particular in the case of transfer of rights in intangibles. BIAC recommends that the OECD clarify this concept in order to prevent uncertainties in situations that are very common, so that there is no ambiguity about the fact that taxpayers and tax authorities can continue to address the less complicated transfer pricing cases related to intangibles in a straightforward way and that, where the one-sided method used was both appropriate and based on sufficiently reliable comparables, there will be no scope for revisiting the transaction.

12. The second condition set in paragraph 9 relates to “lack of reliable projections of future cashflows.” BIAC observes that, in addition to the case of one-sided methods based on comparables discussed above, the OECD should also address the case where profit split is used: BIAC considers that in the case of residual profit split the focus should be on whether the specific methodology has been set in a way consistent with the fact that the transaction included HTVI. In other words, if at arm’s length the reasonable approach to deal with uncertainty was to decide a residual profit split based – for example, on “non-routine” contributions made by each party, this approach should be respected and there should not be a possibility that a tax authority revisit the transaction.

Paragraph 14

13. The approach described in the discussion draft will not apply where the taxpayer:

a. “provides full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in
calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks; and

b. provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.”

14. This seems to set a very high standard of analysis for the taxpayer and the second statement, in particular, appears unnecessarily onerous. For example, if the consensus opinion in 2014 was that oil prices would remain stable, yet in 2015 they fell dramatically, and a few far-sighted analysts did foresee a fall, the second condition could not be met by a taxpayer who took the majority view. This setting of idealistically high standards for taxpayers would be another example where related parties would have to demonstrate much higher standards than unrelated parties and is even more disturbing given that at the time the taxpayer is challenged, the tax authority will have the clear benefit of hindsight. It should be noted that forecasting is very difficult, and many MNE businesses struggle with it, even for an established business. Assumptions are always uncertain. This is equally the case for intra-group transactions and third party transactions. The examples given in the Discussion Draft are rather extreme and the distinction between foreseen and unforeseen is very difficult to make. BIAC also suggests replacing ‘full details’ with ‘significant details’ in paragraph 14.

15. Furthermore, BIAC observes that there may also be cases where the intangible didn’t have the nature of HTVI at the time of the transaction and, therefore, did not require detailed ex-ante projections, but unforeseeable or extraordinary events led to outcomes quite different from those anticipated. In such cases, it should be recognized that ex-ante projections were not required, and the only requisite evidence should be related to the unforeseeable and extraordinary nature of the events. This point also raises the more general concern of burden of proof. BIAC would encourage guidance to be issued on this point that would prevent oversimplified challenges to translate into extremely burdensome justifications to be developed by taxpayers.

Additional points

16. BIAC appreciates the efforts made in the discussion draft to highlight points on which contributions are openly invited; we provide comments here below on each of the specific questions.

a. Mechanisms that could provide greater certainty:

The timeframe within which retrospective adjustment could be possible should be established with reasonable certainty. A short timeframe would be strongly advisable in order to provide certainty to taxpayers and reflect the fact that in third parties dealings certainty is often a desired element. It should also be at least established that in any case adjustments could not be made for years that are statute barred; in addition the taxpayers should be allowed the possibility to use
comparable arm’s length contracts to assess the cut-off timing before which a tax administration should not go with retrospective adjustment.

b. Additional exemptions to the exemption contained in paragraph 14:

BIAC recommends the introduction of additional exemptions in relation to the following cases described above:

i. HTVI’s priced indirectly using one-sided methods;

ii. HTVI’s for which a profit split method has been adopted and construed in a way that was designed to address the HTVI uncertainties within the profit split mechanism itself; and

iii. HTVI’s which did not have the nature of HTVI at the outset (or for which the probability of unforeseeable and extraordinary events was assessed as being so low that it would not be reasonable to require projections to be made for options with such negligible probability).

iv. HTVI’s whose value remains hard to value also ex-post (described below).

c. Definition of the notion of “significant difference”:

In determining when an adjustment may be necessary, the proposed guidelines should recognize that in virtually every case ex-ante and ex-post returns will diverge because ex-post results reflect the realization of risk and other events rather than their anticipation. So, it is very important that the proposed guidance does not apply in the absence of significant divergences between ex-ante and ex-post results. The OECD should adopt a standard that if the ex-post results are within a range of the ex-ante projections, then no adjustment should be required under these provisions. Further, the ex-post results should be examined from a multiple-year perspective (a five-year rolling average, for example) such that individual year anomalies are smoothed out.

d. Further comments:

i. BIAC observes that a special measure should not apply retroactively and would request the OECD to clearly establish that this special measure apply only to prices set after its introduction.

ii. BIAC also would like to stress the point that the symmetry of price adjustments should be recognized. Adjustments may be upward or downward and affect both parties in the exchange. Any one-sided approach that does not take into consideration the symmetry of the taxation burden may lead to double taxation. It is therefore absolutely critical to ensure a global consensus on offsetting adjustments.

iii. BIAC also observes that HTVI’s may remain HTVI’s also ex-post, for example in cases where the transferred intangible or rights in an intangible do not
generate a clearly identifiable income attributable to the intangible, in particular in cases in which the intangible is part of a more complex product or service. In these cases it should be made very clear that the “approach” cannot be utilized to arbitrarily attribute a value to an intangible on an ex-post basis if such intangible remains hard to value: in such cases the standard transfer pricing guidelines should simply apply.

iv. Finally, in the case of transfer of rights in intangibles, it should also be acknowledged that the parties will first monitor results that are significantly different from what was anticipated in order to assess whether the change is permanent or temporary. In addition, independent parties are much more likely to modify pricing prospectively rather than retroactively.
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18 June 2015  

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Through its members, BUSINESSEUROPE represents 20 million European small, medium and large companies. BUSINESSEUROPE’s members are 41 leading industrial and employers’ federations from 35 European countries, working together since 1958 to achieve growth and competitiveness in Europe.  

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Revised Discussion Draft entitled “BEPS Action 8: Hard-To-Value Intangibles” (hereinafter referred to as the Draft).  

As the Draft rightly points out in the introductory paragraph, when valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, the question arises as to how arm’s length pricing should be determined. It is in this respect important that the integrity of the arm’s length principle is maintained and that it is made clear – as is now the case in the first paragraph - that the question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances.  

However, we believe that parts of the proposed guidance are not rooted in the arm’s length principle (and not aligned with the statements in the introductory paragraphs) and find it disturbing that the Draft, effectively, introduces a “commensurate with income” type approach. In addition, we have major concerns with the implication of hindsight under the “presumptive evidence” statement introduced in paragraph 9 of the discussion draft.
In line with the arm's length principle, the intra-group transactions should not be treated differently than similar independent transactions by re-opening a valuation based on ex post information. We would like to emphasize that in most cases, transactions between independent parties do not provide for such a re-valuation.

Furthermore, for some of the examples given, e.g. on transactions regarding intangibles that have only been partially developed, there seems to be no recognition of the fact that the buyer is acquiring the ownership, including the risks attached to the intangible. The risk that the final income deviates from the forecasts is part of the transfer.

Hard-To-Value Intangibles are defined in paragraph 9 of the Draft and covers intangibles or rights in intangibles for which, at the time of their transfer in a transaction between associated enterprises,

(i) no sufficiently reliable comparables exist; and
(ii) there is a lack of reliable projections of future cashflows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain.

Depending on how the terms "sufficiently reliable comparables" and "lack of reliable projections of future cash flows or income" in paragraph 9 are interpreted (which is further commented upon below) the Hard-To-Value Intangibles definition could potentially cover most intangibles. Paragraph 9 then goes on to state that "As a consequence, ex post information provides presumptive evidence as to the reliability of the information used ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles."

In our view, the reasoning becomes almost circular and introduces an element of hindsight. If ex post result deviates from ex ante projections then the (ex ante) projections used (and/or the comparables used) were not reliable and hence an Hard-To-Value Intangible exist, in which case adjustments based on ex post profit levels can be made. If this definition is maintained, it is of utmost importance that at least safeguards are provided to guarantee that the tax administration in the other state respects an adjustment made by the tax administration in the first state. Preferably, some other form of binding conflict resolution should be introduced.

The Draft seems to pre-assume that there is a decisive mismatch in information between tax payers and tax administrations. However, it should be noted that forecasting is very difficult, and many MNE businesses struggle with it, even for an established business and equally in third party transactions. Assumptions are always uncertain. The examples given in the Draft are rather extreme and the distinction between foreseen and unforeseen is very difficult to make. This difficulty of forecasting equally applies to transactions between related parties as well as independent parties.
In addition to the above we fear that the use of certain terms without providing further guidance or definitions, for taxpayers and tax administrations alike, may result in an increasing number of double taxation situations. This would e.g. include; "sufficiently reliable comparables" (para 9), "lack of reliable projections of future cash flows or income", "significant" (para 13), "satisfactory" (para 14, 15), "should have been foreseeable" (para 13), "full details" (para 14), "reasonable foreseeable events" (para 14).

A coordinated approach by tax administrations is required to avoid any double taxation.

There is little doubt that the example in paragraph 6 whereby an enterprise transfers intangibles at an early stage of development to an associated enterprise, sets a royalty rate that does not reflect the value of the intangible at the time of the transfer, and later take the position that it was not possible at the time of the transfer to predict the subsequent success of the product, may reflect non-arm’s length behavior on the part of the taxpayer.

However, the guidance contained in the Draft opens up for arbitrary use of hindsight and is likely to increase uncertainty for taxpayers. In our view, the hard-to-value approach should only be applied in exceptional cases. A preferred approach would be to include guidance on the use of adjustment clauses (milestone payments etc.) recommending that such should be used when it can be expected in third party situations (and preferably give some example in relation to this) and also outline further guidance on how such clauses may typically be designed.

Furthermore, we propose to balance the burden of proof. In the current Draft, the burden of proof is with the taxpayer to evidence that the valuation assumptions were certain. However, as referred to above, projections are always uncertain. In order to avoid that the hard to value approach is applied to almost all situations rather than exceptional cases, we propose to place the burden of proof that assumptions were not certain on tax administrations.

In any case, it should be clearly established that any changes to this chapter should only apply to prices set / transactions occurred after its implementation.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department
CBI RESPONSE TO THE OECD PUBLIC REVISED DISCUSSION DRAFT ON BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES

1. The CBI is pleased to provide comment on the OECD’s revised Discussion Draft on Action 8: Hard-to-value intangibles.

2. As the UK’s leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

3. The CBI continues to support the BEPS programme to update international tax rules to reflect modern business practice, tackle abusive tax structures and target the incidence of double non-taxation. However, we are concerned that if complexity and uncertainty are not avoided, the outcome will be an increase of double taxation and resulting legal disputes, which could have a substantial and negative impact on cross border trade and investment, but also on tax administrations with limited resources.

Comments

4. The CBI welcomes the approach of trying to keep the difficult issue of dealing with hard-to-value intangibles within the arm’s length principle. We accept that some adjustment mechanism may be appropriate to deal with circumstances where the taxpayers approach and/or documentation are inadequate and therefore could potentially benefit from this.

5. However, the measures (e.g. using ex post information) should only be used in exceptional and material circumstances. The current wording appears to be too broad and open to widespread application to many situations. The approach adopted has features of a special measure in so far that it appears to be currently drafted as a one-sided penalty adjustment provision. We recommend, that to avoid these provisions creating double taxation, a practical mechanism is also developed to ensure a corresponding adjustment can be claimed in the purchasing jurisdiction.

Use of ex post results in an arm’s length context

6. As outlined in our previous submission in January on the previous discussion draft on Actions 8-10, the use of earn-out clauses in commercial deals relating to the transfer of intangibles remains overstated. In the significant majority of third party transactions, a seller would be looking to divest all future risk, whilst a purchaser would normally be looking for the reward of taking on the full risk of the asset. This should be made clear in the guidance to ensure that related party transactions are not made more burdensome than external transactions and do reflect the transactions that do occur between
unrelated parties.

7. It is still unclear as to how post transaction revenues are to be measured given that in most cases, the intellectual property will be subject to continuous development and potential changes to the external market which cannot be foreseen at the time of sale. New technologies may have a positive or negative impact. Significant global events may impact the economy. It is unlikely that assumptions made in modelling future returns at the time of the sale will all be relevant place post sale. Where an asset is subject to continuous development, it should be clear that any upside/downside that relates to post sale development should be entirely allocable to the purchasing company.

8. It is also unclear from the discussion draft as to how low probability items should be dealt with. In evaluating the valuation of an intangible, it is likely that not all variable factors will be priced into a transaction. For example, a potential risk may be considered but it is only given a 5% chance of happening. Therefore given the small level of risk, it was determined that no adjustment would have been made in similar negotiations with a third party. Post transaction, the issue does actually become a reality – however, based on the paper (paragraph 14, subparagraph 2), as the risk was known but not priced in, there could be a risk that ex-post data could then be used by tax authorities to impose an adjustment.

9. It should be noted that forecasting is very difficult even for an established business. Assumptions are always uncertain. The examples given are rather extreme and the distinction between foreseen and unforeseen is very difficult to make in practice. The difficulty of forecasting equally applies to transactions with 3rd parties as well as intra-group. In line with the arm’s length principle, intra-group transactions should not generally be treated differently by re-opening a valuation based on ex-post information.

10. The discussion draft predominantly focuses on valuation models using future cash flows. However, there are different valuation models which may be used between third parties (such a profit splits) and therefore it should be made clear that it is the assumptions in any appropriate model that are relevant, and not just projections about future cash flows which should be taken into account.

**Measures for Greater Certainty**

11. Most transactions between independent parties would not be undertaken on a contingent basis, or have price adjustment clauses. Taxpayers want certainty that if they undertake a transaction for a specific price, then provided that is a realistic valuation, and they follow the guidance on documentation, there should be no recourse to ex-post results. Our concern is that the proposals essentially put the onus on taxpayers to prove valuations are “reliable”. The use of ex-post data should be restricted to a very small set of cases where the taxpayer has manifestly not undertaken any serious valuation and/or the pricing is so difficult it is highly unlikely third parties could ever have arrived at a valuation (and thus in all probability would not have entered into any transaction at all).

- The burden of proof should reflect this; a taxpayer should not be required to provide subsequent information to evidence that the valuation assumptions were certain. The current proposals seem to be based on the assumption that taxpayers have more information on the certainty of the projections. This is generally not the case.
- In line with the above, CBI suggests to at least replace ‘full details’ (paragraph 14) with ‘significant details’.

Furthermore, for some of the examples given, e.g. on transactions regarding intangibles that are only partially developed, there seems no recognition of the fact that the buyer is acquiring the full ownership, including the risks attached to the intangible. The risk that the final income deviates from the forecasts is part of the transfer.
12. The commercial world is littered with examples of where companies have invested poorly in intangibles and also where things have performed well (but not in a way the companies had anticipated) and adding value to the group. In both cases it would be unacceptable for a group to be penalised where a tax authority were to take financial data and try to connect the dots looking backwards in order to ascertain value and estimate how much an arm’s length rate would be based upon this (new) information. If a taxpayer has determined the transaction at an arm’s length rate at the time of the acquisition, this should be sufficient.

13. In order to provide greater certainty, we would recommend making paragraph 10 a definition of a HTVI. We would achieve this by removing the word *may* in the first sentence.

*Intangibles falling within the category of HTVI may exhibit one or more of the following features.*

14. The guidance notes would also greatly benefit from a time-limit on how long into the future tax authorities may challenge so taxpayers will get absolute certainty at some point in. We accept that there may not be a single number that is appropriate for all transactions, as the useful life and nature of an intangible varies greatly, but a guide on how it should be determined must be included.

**Exemptions**

15. We have no specific requests for additional exemptions though would note our comments above regarding incorporating wording for low probability outcomes.

**“Significant difference”**

16. The term significant difference does need guidance in its own right and examples of the approach to be taken.

17. One approach could be to look at a % of the transaction value. However, such an approach *must* be a safe-harbour only and it be made explicitly clear that failing the % would not automatically trigger an adjustment. If a taxpayer is able to meet the conditions in paragraph 14, despite exceeding the %, then that would negate the need for any adjustments to be made. We believe this is the intention of paragraphs 13 and 14 but it would be helpful to make this clearer and tighter.

**“Practical and Consistent Implementation”**

18. We would recommend that the changes to this chapter are only applied to transactions carried out after the date of implementation. This should deter tax authorities trying to use these new provisions to settle old existing audits.

19. We trust that you will find the above comments helpful in understanding the potential impact of the proposals outlined in the Discussion Draft. We remain committed to ensuring that each BEPS Action achieves its stated goals, whilst ensuring that genuine business transactions are not unduly impacted.

20. We remain at your disposal should you wish to discuss the issues we have raised in this paper in more detail. Please contact neil.anthony@cbi.org.uk for more information.
June 18, 2015

Sent via email to: TransferPricing@oecd.org

Mr. Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
Organization for Economic Co-operation and Development
2, rue André Pascal
75775 Paris Cedex 16
France

Dear Sirs:

Re: Comments on Discussion Draft on Hard-to-Value Intangibles

The Canadian Institute of Chartered Business Valuators (CICBV) is pleased to provide comments on your Discussion Draft on Hard-to-Value Intangibles and the revisions to the existing guidance in Section D.3 of Chapter VI of the Transfer Pricing Guidelines (“Guidelines”).

BACKGROUND ON THE CICBV
The CICBV is the largest professional business valuation organization in Canada, with over 1,700 Members. It is a self-regulated organization that grants to those who have completed its comprehensive education program in business valuation, passed its rigorous examination process and attained suitable business valuation experience the Chartered Business Valuator (CBV) / expert en évaluation d'enterprises (EEE) designation. The CICBV has a strict Code of Ethics and comprehensive Practice Standards with which all its Members must comply. The vast majority of our Members hold professional designations in addition to the CBV/EEE, such as CPA and CFA. In addition to providing a broad range of business valuation services to Canada's business, legal, investment, banking and government communities, our Members are also active in other areas, such as financial advisory services, transfer pricing advisory services, valuation for financial reporting, the quantification of economic damages, and business management. Our Members are regularly involved in valuing intangible property in the context of the transfer of such types of property both within, and outside of, Canada. The high quality of our Member’s work and the importance of the CICBV professional standards are recognized by the Government of Canada’s taxation authority – the Canada
Revenue Agency (CRA), by Canadian securities regulators and by Canadian courts.

**CICBV’s PARTICIPATION**

The CICBV commends the work that the OECD has undertaken to date in relation to developing guidance on the transfer pricing of intangibles, and offers its assistance to the OECD in support of its efforts. We believe that it is important for the transfer pricing, tax and valuation professions to collaborate on this project. The CICBV appreciated the opportunity to address the WP6 in March, October 2011, and November 2012, and would welcome the opportunity to address the WP6 again to present or clarify our views and comments on the Guidelines.

**COMMENTS ON THE DISCUSSION DRAFT**

**Overall Comments**

The CICBV recommends that the OECD discourage the use of an ex post or “hindsight” analysis. The pricing determination should be based on information that was known or reasonably foreseeable to the related entities at the time the transaction was undertaken.

Arm’s length parties agree on specific terms in advance and commit to performing their obligations pursuant to the contract’s terms. The use of ex post data suggests that related parties or tax authorities should be free to re-negotiate contracts at any moment based on the assumption that the contracts may be unilaterally re-negotiated. This is conceptually and practically unrealistic.

Ex-post information to be considered should only include information that could have been reasonably anticipated at the time the transaction was undertaken and that would have affected the pricing that would have been agreed between independent enterprises in similar circumstances.

Despite the difficulty in determining a transfer price for intangibles, using hindsight to determine their value is not appropriate. Under the arm’s length principle, an agreement that is, in substance, the same as one into which arm’s length parties would have entered, would not usually be subject to adjustment by a tax administration as a result of subsequent events. Therefore, it would be inconsistent with the arm’s length principle for a tax administration to require, or accept, an adjustment solely on the basis that the income streams or cost savings differ from those initially estimated by the parties. However, factors that a reasonable person with some knowledge of the industry would have taken into account at the time of the transaction would be acceptable.

The task of valuing an intangible can be challenging, particularly if the transfer occurs during the period of development when full commercial potential is uncertain. Yet despite the challenges, particularly for what later becomes a highly valuable unique intangible, taxpayers and tax authorities must arrive at compensation for its transfer. When there is uncertainty as to the value at the time of the transaction, taxpayers still rely on those valuation techniques commonly employed in the open marketplace (e.g., discounted cash flow analysis), and would expect these to be consistent with the arm’s length principle. The use of ex-post information should be justified only if the information was known or reasonably foreseeable to the taxpayer.
at the time of the transaction. The arm’s-length principle generally must be applied on an ex ante basis, that is, based on information that was known or reasonably foreseeable at the time of the transaction. This reflects the situation unrelated taxpayers face in the marketplace. To do otherwise would result in a compensation for transfer that is not based on market values.

It is also critical for the guidance to recognize that a change in the form of payment inevitably impacts the determination of the arm’s length price for the intangible transfer. The arm’s length nature of an agreement can only be determined by reference to facts in existence at the time of the agreement.

Commensurate with notion of time-specific knowledge hindsight information, it is generally accepted that hindsight evidence should not be considered. Canadian courts have generally found hindsight evidence to be inadmissible and cannot be used as part of the process of establishing the value of an intangible at a particular date. Canadian courts sometimes permit the limited use of factual hindsight information only to determine whether or not subsequent events confirm the reasonableness of assumptions made at the time of the transaction. Hindsight or ex-post information has therefore been found to simply be one factor that may be considered in post-valuation date evidence, not in the actual value determination itself.

The use of hindsight was debated in *In the Ford Motor Company of Canada, Ltd. v. Ontario Municipal Employees Retirement Board*, Court of Appeal for Ontario, 2006. In this case, the Ontario Court of Appeal agreed that minority shareholders of Ford Canada were entitled to damages as a result of unfair transfer pricing between Ford Canada and its U.S. parent, the Ford Motor Company. Ford had submitted that the trial judge erred in using hindsight to find oppression as follows:

> Ford also submits that the trial judge erred in using hindsight to find oppression. Ford lays much of the blame for the decline in profitability on the drop of the value of the Canadian dollar along with other financial reversals in the Canadian economy that were unexpected, difficult to predict and difficult to protect against.

The Court of Appeal however stated as follows:

> “I emphasize that this is not an exercise simply with the too easy benefit of hindsight. While these amounts would not be known with any precision through foresight, the probability each year of results for the next year which would ultimately lead to overall cumulative results of this magnitude would be reasonably foreseeable.

> I therefore reject Ford Canada’s argument that the trial judge erred in using a hindsight approach.”

Canadian courts accept “hindsight” to the extent that the events in question could be said to be reasonably foreseeable when the transaction was entered into. Taking into account, after the fact events, would not be considered “hindsight”, as suggested by the *Ford* decision. Depending on the facts and circumstances, hindsight could be accepted only to test the reasonableness of the valuator’s assumptions.
The Guidelines seem to be relying on the notion that it would be commercial practice that the parties to a transfer include price adjustment clauses or would renegotiate the pricing arrangements to justify the application of ex post or hindsight information. This notion is described in the discussion paper only as a possibility. In recognition of this uncertainty, exception to the use of ex post information (paragraphs 13 to 15) is limited to “where such a difference is due to developments or events that were or should have been foreseeable at the time of the transaction”. It should be recognized that the transfer of intangible assets is usually a risky endeavor for all parties and such risk is an integral part of the value determination. Price adjustment mechanisms or renegotiation assumed as part of the valuation determination would alter the risk profile of the cash flows used in the value determination. It would be inappropriate to subsequently adjust for this risk by assuming that such price adjustments or renegotiation would have been included or taken place without also altering the rate of return requirement used in the value determination.

With respect to the proposed exemptions, we are of the view that there can be many reasons for circumstances to evolve in the ex post period that differ from that which were reasonably projected at the valuation date and it would be inappropriate to restrict the use of the exemption to such very limited criteria. If value is determined based on an arm’s length basis, the uncertainties that exist at the valuation date are an integral part of the market value at that time. The test should be that the projected results that were the basis of the value determination was based on information that was known or reasonably foreseeable at the time of the transaction, consistent with the arms-length principle.

Comments on Specific Questions

1. Are there mechanisms that could be adopted to provide greater certainty for taxpayers regarding the application of the approach to hard-to-value intangibles?

   a) Ex-post data should be used to assess the reasonableness of the projections and to trigger further enquiry rather than to process a transfer pricing adjustment;

   b) Given that:

      i) There is seldom sufficiently reliable comparables for intangible property; and

      ii) There will likely be wide possible interpretations of what constitute reliable projections or highly uncertain assumptions

      We would suggest that the application of a proposed approach be limited to the illustrations in paragraph 10 in addition to the conditions in paragraph 9.

   c) Changing the form of the transaction should be done bilaterally or multilaterally, depending on the number of entities involved in the transaction, in order to ensure that changes are not made unilaterally, which would likely lead to uncertainty and double taxation.
2. Should the discussion draft include any additional exemptions?

It is critical for the guidance to include a clear exemption where evidence is provided that subsequent events have a material effect. It would otherwise, in most cases, be impossible to quantify the portion of the discrepancies that relate specifically to those subsequent events.

The level of detail of ex-ante projections required for the suggested approach not to apply, should not be exhaustive as this would create an unreasonable and unpractical compliance burden. A description of the type of information expected should be provided. For example, a scope of review that clearly identifies the specific information relied upon and the basis, rational and reasons for the methods and key assumptions used should suffice.

The tax administration should be expected to provide evidence to support its doubt as to the reliability of the information on which the ex-ante pricing was based.

3. Does the OECD need to define the notion of ‘significant difference’? If so what mechanism could determine whether a difference is significant?

In order for the notion of `significant difference' not to apply to most, if not all, cases involving the transfer pricing of intangibles, the notion needs to be linked to a concept of great magnitude and in no way be influenced by subsequent events or information that could not have been known or foreseeable. The potential impact of the information that would have been reasonably known or foreseeable should be both probable and determinable at the time of the transaction. Whether, and if so, at which rate the potential impact would have been recoverable or adaptable, should also be determinable. Consideration of the use of the impacted area for other purposes would also have to be considered.

A professional opinion could be sought on the impact of the difference on the investor’s required rate of return relative to that required for the industry generally at the time of the transaction.

4. What matters would be useful in any follow-up guidance on the practical and consistent implementation of the approach?

Global monitoring and public reporting of the application of the adopted approach may inform the need for follow-up guidance.

We hope that our comments are helpful to you. It is our belief that input from members of the valuation profession will be an essential element of your considerations in this area. In this regard, we would be pleased to continue to work with you.
If you have any questions regarding our comments, please do not hesitate to contact Robert H. Boulton, CPA, CA, CBV, our Director, Education and Standards (email: robert.boulton@cicbv.ca).

Yours truly,
Richard Ginsberg, CPA, CA, CBV
Chair, Professional Practice and Standards Committee
BEPS Action 8: Hard-to-value Intangibles
Response by the Chartered Institute of Taxation

1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) is pleased to submit this response to the discussion draft issued on 4 June 2015 by the OECD which looks at BEPS Action 8: hard-to-value intangibles (‘HTVI’).

1.2 Stakeholders in the BEPS project are aware that the pricing of inter-company transfers of intangibles has been a significant concern of tax authorities for a number of years. Tax authorities have, in public forums, shared examples of ‘mis-pricing’ of intangible transfers, where an enterprise has transferred an intangible at a low value which has subsequently generated a very substantial income stream. It is a clear concern of tax authorities that multi-national enterprises are able to erode tax bases through moving intangibles to low tax territories.

1.3 We agree that it is a legitimate goal of the BEPS project to develop ways of preventing such behaviour. In reviewing the proposals for the use of ex-post data in valuations put forward in the discussion draft, we have thus focused on the question of whether the proposals succeed in doing so without affecting commercial transactions not motivated by achieving tax reductions.

2 Comments on proposed revised guidance in Section D.3 of the BEPS Report containing Guidance on Transfer Pricing Aspects of Intangibles

2.1 It is crucial that the proposals should not introduce into the international tax system the ability for tax authorities to open transfer pricing disputes or re-open agreed positions based solely on the application of hindsight where the authority simply does not like the ultimate outcome of the transaction. Business transactions involve an element of risk, and in commercial situations sometimes matters will not turn out as expected. We welcome the recognition of this distinction in Paragraph 7 of the
2.2 We agree with the definitions of HTVI put forward in paragraph 10 of the proposed revised guidance. However, we would point out that even for such intangibles, data points may be available for their value. For example, if the intangibles have recently been acquired as part of an acquisition of a company a valuation for accounting purposes will often have been prepared, so that the various assets acquired can be properly stated in the acquirer’s balance sheet. Any subsequent transfer would be likely to draw on this evidence, and we suggest that this is the type of ex-ante information that tax authorities should be able to rely on. Our understanding of paragraph 12, is that the existence of such evidence would restrict the ability of tax authorities to use ex-post evidence. If this is not what is envisaged, or, in practice tax authorities do not take account of such evidence, the proposals would start to impinge on commercial merger and acquisitions activity as the tax consequences of post-acquisition reorganisations would have increased uncertainty.

2.3 Where a company is active in both developing IP and acquiring IP through acquisition, there may well be a read-across from acquisition activity to the value of intangibles in development. This should further widen the pool of ex-ante evidence available and reduce the incidence of ex-post data being used.

2.4 We suggest that the use of ex-post data should only apply to a small set of transactions, where the taxpayer can provide little evidence that, at the time of the transaction, there was a basis for valuation. Transactions between connected persons where there is little or no evidence for valuation are likely to be transactions of a type that would not take place between third parties. This is because, if there really is no reliable basis for valuation at the point of the transaction, it would be extremely difficult for third parties to agree on a price. The use of ex-post data to such transactions would be reasonable.

2.5 The corollary is that if a taxpayer can provide sufficient evidence for the basis of valuation, then there is little justification for the use of ex-post data.

2.6 We are concerned that the discussion draft proposals go somewhat beyond this. The proposals appear to have a presumption that in any case where a HTVI is involved, then there will be an information asymmetry between taxpayer and tax authority. We are concerned that in any situation where there is a significant difference between the ex-ante projection and ex-post outcome, the tax authority will question the reliability of the data provided by the taxpayer, and argue that it is unable to confirm the reliability of the taxpayer projections. Whilst the exceptions set out in paragraph 14 are intended to safeguard the taxpayer, they appear to us to put the onus on the taxpayer to provide substantial information to rebut a presumption that there has been mis-pricing where there is a significant difference between ex-ante projections and ex-post outcomes, rather than the use of ex-post data only being permitted where there is a failure by the taxpayer to provide reasonable justification for the valuation used.

2.7 We suggest that thought should be given to including some further guidance as to appropriate checks and balances which should be implemented by tax authorities to ensure that the proposals do not have an unwarranted negative effect on commercial transactions not motivated by achieving tax reductions. Such checks and balances could include:

2.7.1 Tax authorities should state during the ordinary tax review process whether a transaction is likely to be subject to the ex post revision approach. This would
prevent tax authorities acting retrospectively too long after the transaction, simply with the benefit of hindsight. The quality of the evidence provided by the taxpayer should be considered at the earliest possible time, which may give a taxpayer an opportunity to address any uncertainty of the tax authority around the quality of evidence that has been provided, for example by providing more information or analysis or bearing the cost of an independent third party providing advice/expertise to the tax authority.

2.7.2 Tax authorities should be required to state their reasons for concluding that a transaction may be subject to the ex-post revision approach and those reasons should be appealable/subject to challenge through normal appeal/review procedures.

2.7.3 There should be a cut-off date for ex-post evidence adjustments. That date should be the cut-off date for the transaction counterparty to claim a corresponding adjustment to its own tax position. So if Jurisdiction A allows tax adjustments within a 3 year period and Jurisdiction B allows a 5 year period, the period is 5 years if Jurisdiction A is challenging and 3 years if Jurisdiction B is challenging.

3 Effect of the proposals

3.1 These proposals will inevitably mean that tax positions will have to remain open longer. For multi-national enterprises which remain unchanged for the period of uncertainty, the implications will not be that serious. However, these open tax positions will create difficulties and complications for any form of group restructuring or third party merger and acquisitions activities. For example, if a group decides to close down its UK R&D activities and move the business to the US, it may be unable to liquidate the subsidiaries because of the risk of a tax adjustment. Equally, the group may be unable to sell its UK R&D subsidiary or amalgamate with another business due to tax uncertainty.

3.2 In terms of the behavioural response of taxpayers, it is likely that the proposals will lead to taxpayers choosing not to transfer intangibles within a group where there is any material degree of uncertainty over value – whether or not the transfer may be base-eroding, or how well the taxpayer believes it can justify its approach to valuation – as the tax result of such transactions will be uncertain as a result of the increased ability of tax authorities to consider ex-post data.

3.3 It follows that, given taxpayers will recognise that it will be difficult to transfer intangibles with certainty of tax treatment until they are sufficiently well developed for future income to be reasonably well measured, where intangibles are developed will become of greater significance. It would be rational for taxpayers to expand the development of intangibles in low tax territories, and within regimes such as ‘Patent Boxes’ to optimise the tax treatment of the future income derived from these intangibles.

3.4 In conclusion, we accept that ex-post data is useful in certain circumstances in the pricing of HTVI, and is likely to assist in preventing base erosion. However, its use should be restricted to cases where taxpayers cannot provide reasonable justification for ex-ante projections. In any event, it is likely to lead to a concentration of development of intangibles in low tax and tax favoured regimes.

4 The Chartered Institute of Taxation
4.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 17,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
18 June 2015
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Submitted by email: TransferPricing@oecd.org

Confederation of Swedish Enterprise - Comments on the OECD Public Discussion Draft entitled: "BEPS Action 8 Hard-to-Value Intangibles"
4 June 2015 - 18 June 2015

The Confederation of Swedish Enterprise is Sweden’s largest business federation representing 49 member organizations and 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled “BEPS Action 8 Hard-to-Value Intangibles” 4 June 2015 – 18 June 2015 (hereinafter referred to as the Draft).

As pointed out in the introductory paragraph of the Draft, when valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, the question arises as to how arm’s length pricing should be determined. In this situation it is of utmost importance that the integrity of the arm’s length principle is maintained and that it is made clear – as is now the case in the first paragraph - that the question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances.

In our view, it is crucial that the guidance is clear and predictable and that the proposed hard-to-value approach is targeted only on exceptional cases. Regrettable, that does not seem to be the case. We believe that parts of the proposed guidance are not rooted in the arm’s length principle (and not aligned with the statements in the introductory paragraphs) and find it disturbing that the Draft, effectively, introduces a “commensurate with income” type approach. In addition, we have major concerns with the implication of hindsight under the “presumptive evidence” statement introduced in paragraph 9 of the discussion draft.
In line with the arm’s length principle, the intra-group transactions should not be treated differently than similar independent transactions by re-opening a valuation based on ex post information. We would like to emphasize that in most cases, transactions between independent parties do not provide for such a re-valuation.

Furthermore, for some of the examples given, e.g. on transactions regarding intangibles that have only been partially developed, there seem to be no recognition of the fact that the buyer is acquiring the ownership, including the risks attached to the intangible. The risk that the final income deviates from the forecasts is part of the transfer.

Hard-To-Value Intangibles are defined in paragraph 9 of the Draft and covers intangibles or rights in intangibles for which, at the time of their transfer in a transaction between associated enterprises,

(i) no sufficiently reliable comparables exist; and
(ii) there is a lack of reliable projections of future cashflows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain.

Depending on how the terms "sufficiently reliable comparables" and "lack of reliable projections of future cash flows or income" in paragraph 9 are interpreted (which is further commented upon below) the Hard-To-Value Intangibles definition could potentially cover most intangibles. Paragraph 9 then goes on to state that “As a consequence, ex post information provides presumptive evidence as to the reliability of the information used ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles.”

In our view, the reasoning becomes almost circular and introduces an element of hindsight. If ex post result deviates from ex ante projections then the (ex ante) projections used (and/or the comparables used) were not reliable and hence an Hard-To-Value Intangible exist, in which case adjustments based on ex post profit levels can be made. If this definition is maintained, it is of utmost importance that at least safeguards are provided to guarantee that the tax administration in the other state respects an adjustment made by the tax administration in the first state. Preferably, some other form of binding conflict resolution should be introduced.

The Draft seems to pre-assume that there is a decisive mismatch in information between tax payers and tax administrations. However, it should be noted that forecasting is very difficult, and many MNE businesses struggle with it, even for an established business. Assumptions are always uncertain. The examples given in the Draft are rather extreme and the distinction between foreseen and unforeseen is very difficult to make. This difficulty of forecasting equally applies to transactions between related parties as well as independent parties.

In addition to the above we fear that the use of certain terms without providing further guidance or definitions, for tax payers and tax administrations alike, may result in an increasing number of double taxation situations. This would e.g. include; "sufficiently reliable comparables" (para 9), "lack of reliable projections of future cash flows or income", "significant" (para 13), "satisfactory" (para 14, 15), "should
have been foreseeable" (para 13), "full details" (para 14), "reasonable foreseeable events" (para 14).

There is little doubt that the example in paragraph 6, whereby an enterprise transfers intangibles at an early stage of development to an associated enterprise, sets a royalty rate that does not reflect the value of the intangible at the time of the transfer, and later take the position that it was not possible at the time of the transfer to predict the subsequent success of the product, may reflect non-arm's length behavior on the part of the taxpayer.

However, the guidance contained in the Draft opens up for arbitrary use of hindsight and is likely to increase uncertainty for taxpayers. As previously stated, it is our view that the hard-to-value approach should only be applied in exceptional cases. A preferred approach would be to include guidance on the use of adjustment clauses (milestone payments etc.) recommending that such should be used when it can be expected in third party situations (and preferably give some example in relation to this) and also outline further guidance on how such clauses may typically be designed.

Furthermore, we propose to balance the burden of proof. In the current Draft, the burden of proof is with the taxpayer to evidence that the valuation assumptions were certain. However, as referred to above, projections are always uncertain. In order to avoid that the hard-to-value approach is applied to almost all situations rather than exceptional cases, we propose to place the burden of proof that assumptions were not certain on tax administrations.

On behalf of the Confederation of Swedish Enterprise

June 17, 2015

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Submitted by email: TransferPricing@oecd.org  

June 18, 2015  

Ref: OECD DISCUSSION DRAFT: BEPS ACTION 8, HARD-TO-VALUE INTANGIBLES  

Dear Mr. Hickman:  

Deloitte Tax LLP1 (“Deloitte”) appreciates the opportunity to submit comments, on behalf of the Deloitte U.S. tax practice, regarding the Organization for Economic Cooperation and Development’s (OECD’s) Discussion Draft on BEPS Action 8: Hard-To-Value Intangibles (“HTVI”) (the “Discussion Draft”) and to contribute to the commentary that will take place at the public consultation scheduled for July 6-7, 2015, at the OECD’s headquarters in Paris.  

Comments  

Paragraph 9 of the Discussion Draft sets out approaches that tax authorities “may” adopt in dealing with HTVIs. Deloitte believes that if such guidance is included in the Transfer Pricing Guidelines, it should not be optional. The use of the word “may” suggests that tax administrators have the option of applying the guidance or not. If a tax authority determines that the guidance applies to a transaction, the tax administrator in the counterparty jurisdiction should not have the option to elect not to apply the guidance, because if one tax administrator properly applies the guidance to increase taxation in its jurisdiction, and the tax administrator in the counterparty jurisdiction chooses not to apply the guidance, double taxation will result.  

Deloitte believes that the examples in Paragraph 10 of intangibles that exhibit features of HTVIs are not clear and, as a practical matter, could be interpreted to include virtually every intangible transaction. For example, it is unclear which intangibles would fall within the definition of a 

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1 Deloitte Tax LLP is the U.S. member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”). DTTL and each of its member firms are separate and distinct legal entities. DTTL itself does not provide professional services of any kind. Please see www.deloitte.com/about for a detailed description of DTTL and its member firms.
“partially developed” intangible. Is a partially developed intangible an intangible that has not been commercialized, or is it an intangible that will be further developed or enhanced? If the definition is an intangible that will be further developed or enhanced, few technical or scientific intangibles in today's fast-moving environment are not subject to further development or enhancement. Similarly, virtually no brands are static; rather, they are constantly subject to further development and enhancement. Other examples in the paragraph use imprecise terms and phrases, such as “several years following the transaction” and “novel,” which could be interpreted expansively. Deloitte believes the examples should be either substantially tightened or deleted.

Deloitte is concerned that the Discussion Draft could significantly increase uncertainty and controversy regarding the correct transfer price of intangibles in virtually every case, because deviations from ex ante expectations occur in practically every related and unrelated intangible transaction. Deloitte welcomes the opportunity offered in the Discussion Draft to provide suggestions to increase certainty for taxpayers on the application of the guidance, including suggestions on when deviations should not be considered “significant.” Deloitte believes that the adoption of the following two safe harbors will decrease uncertainty and controversy while not inappropriately limiting tax authorities’ ability to apply the principles contained in the Discussion Draft:

• Because deviations from ex ante expectations occur in virtually every unrelated and related-party intangible transaction, adoption of a safe harbor that would require the deviation between ex ante and ex post results to be greater than 120 percent or less than 80 percent of the expected ex ante value before allowing the application of the HTVI guidance would be helpful in reducing uncertainty.

• Similarly, limiting the time frame for the application of the HTVI guidance would increase certainty and be consistent with the arm’s length standard. We suggest limiting the period during which the HTVI guidance can be applied to no more than 10 years after the transaction, except in situations involving extremely long periods before commercialization. Experience suggests that projections beyond that period by both unrelated and related parties are almost always subject to “significant” deviation, because the range of potential outcomes increases over longer periods of time.

Paragraph 14 of the Discussion Draft states that unforeseeable and extraordinary developments or events that occur after the determination of the price could not have reasonably been taken into account in determining the arm’s length price. Examples of unforeseeable and extraordinary developments are natural disasters and bankruptcy of a competitor. Deloitte believes that unforeseeable and extraordinary events are better defined as low-probability events outside the control of the taxpayer whose impact on the transaction 

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2 Because valuations are performed ex ante based on probability-weighted averages, but ex post results are determined based on the actual realization of risk, by definition ex post results will diverge from ex ante averages.

3 See footnote 2.
is highly uncertain. We agree that natural disasters and a competitor’s bankruptcy fall within this category, but we also believe that unforeseen governmental actions and major unanticipated macroeconomic events (recessions, depressions, or greater than expected economic growth) also fall within this category and should be added to the list to provide additional clarity. In our experience, these low-probability events rarely have a significant impact on the prices of transactions, but when they do occur they have a significant impact on ex post outcomes.

Paragraph 3 of the Discussion Draft states that unrelated parties may include price adjustment clauses in their agreements as a method to account for uncertainty in some situations. Paragraph 19 of the Discussion Draft on Cost ContributionArrangements issued on April 29, 2015, acknowledged the validity of such adjustment clauses. Deloitte believes that the Discussion Draft should specifically acknowledge that price adjustment clauses negotiated at the time of the transaction permitting price adjustments that increase and decrease originally negotiated prices based on clear criteria and consistent with third-party transactions should be respected as consistent with the arm’s length standard.

We hope Deloitte’s comments are useful and provide thoughtful observations on some of the positions taken in the Discussion Draft. We welcome any questions you may have in connection with these comments. Please contact John Wells (johnwells@deloitte.com) or Philippe Penelle (ppenelle@deloitte.com) if you have any questions about this submission or wish to discuss any of the issues discussed herein.

Sincerely,

John M. Wells
U.S. Transfer Pricing Leader
Deloitte Tax LLP
Andrew Hickman  
Head of Transfer Pricing Unit  
Centre for Tax Policy and Administration  
Organisation for Economic Co-operation and Development  

By Email: TransferPricing@oecd.org  

18 June 2015  
Our Ref: WJID/AL  

Dear Andrew  

BEPS Action 8: Hard-to-value intangibles  
Thank you for the opportunity to comment on BEPS Action 8: Discussion Draft on Hard-to-value intangibles published on 4 June 2015 (the ‘Discussion Draft’). These comments are written from the perspective of the UK.  

It is important that guidance in relation to the treatment of intangibles is as clear and unambiguous as possible. Any new guidance should, as a fundamental objective, seek to minimise the number of disputes and disagreements in this area. The proposals as currently drafted do not give sufficient certainty to businesses (nor tax authorities) and would appear to increase the likelihood of disputes that will require time and resources from businesses and tax authorities to resolve, and may lead to double taxation where resolution is not available.  

Whilst transactions involving transactions between third parties might include a price adjustment clause in some cases, in many others they do not. Decisions in commercial court disputes have supported the view that valuation should be made on the basis of conditions and information available before the transaction takes place. As such, there is considerable uncertainty as to whether a requirement for ‘mandatory’ use of a price adjustment process based on actual results would, in all cases, be arm’s length. In order to address this uncertainty (and to give assurance both to businesses and tax authorities that a price adjustment clause will be upheld in any legal dispute) a helpful approach would be to amend Article 9 of the OECD Model Tax Treaty (and consequently bilateral tax treaties by way of the proposed multilateral instrument) to make clear that defined hard-to-value intangibles will be subject to a specific approach requiring a mandatory price-adjustment process. (Such an approach would be in line with the original ‘special measure’ put forward in the discussion draft on Risk, Recharacterisation and Special Measures released in December 2014). An illustration of the steps that could be applied to provide such a solution are set out in Appendix 1.  

The Discussion Draft, as currently drafted, presents challenges for businesses and tax authorities in determining when the arm’s length principle should apply and when, instead, ‘special considerations’ (and hindsight) should be applied. The lack of clarity will lead to different interpretations, and of particular concern to businesses is the use of the word ‘may’ in paragraph 12. This suggests that it is optional for tax authorities to take the view that a price adjustment approach should be used, and raises significant concerns that only the tax authority that sees a potential upward adjustment of profits will do so. This will be difficult,  

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1 See, for example, Force India Formula One Team Limited v Aerolab SRL ([2012] EWHC 616)
for example, if evidence of third party behaviour in comparable transactions does not support use of a price adjustment clause.

Further comments regarding the specific questions raised in the Discussion Draft are set out in Appendix 2.

If you would like to discuss any of the points raised in this letter, please do not hesitate to John Henshall (jhenshall@deloitte.co.uk), Alison Lobb (alobb@deloitte.co.uk) or me (bdodwell@deloitte.co.uk). We would be happy to speak on this topic at the public consultation meeting on 6-7 July 2015 if it would be helpful.

Yours sincerely

WJI Dodwell
Deloitte LLP
Appendix 1

Illustration: steps to provide a pragmatic approach to hard-to-value intangibles

- A clear definition of what constitutes a ‘hard-to-value’ intangible (this could be developed from the features identified in paragraphs 10 and 11 of the Discussion Draft).
- A requirement under Article 9 of an applicable double tax treaty that where a hard-to-value intangible (as defined) is transferred intra-group the arm’s length principle will be substituted with a requirement that the transfer value will be subject to ‘special considerations’.
- Special considerations, as set out in the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*, requiring hard-to-value intangibles to be subject to a mandatory price adjustment process for a period of [3-5] years. This time period may be extended where competent authorities of both countries agree that the type of intangible, industry, development period and market conditions would mean that third parties would consider a longer period when determining the value of a hard-to-value intangible.
- The adjustments should be made (on a cumulative basis) where there is a differential of more than 20% from the projected outcomes used.
- Where there is a mandatory price adjustment process, all parties to the transaction should be obliged to make (under self-assessment or other appropriate tax return approach) adjustments in relation to the intangible, (provided these have been calculated in accordance with the principles set out in the guidelines) including both upward and downward income adjustments where these have been included in intra-group contractual arrangements, without the need for automatic recourse to Mutual Agreement Procedures (MAP). (This does not preclude any concerns over the amounts recorded in tax returns or how they are calculated from being the subject of a tax authority audit and potentially a dispute requiring resolution under MAP).
- An intangible that does not meet the definition of ‘hard-to-value’ should be subject to transfer pricing under the arm’s length principle (and therefore on an *ex ante* basis) in accordance with normal principles and the guidance elsewhere in Chapter VI of the Transfer Pricing Guidelines.
Appendix 2

1. Comments are invited on whether there are mechanisms that could be adopted to provide greater certainty for taxpayers regarding the application of the approach to HTVI.

Defining hard-to-value intangibles

Paragraphs 9 and 10 of the Discussion Draft set out some helpful features of hard-to-value intangibles where ‘special considerations’ may be required, but these fall short of a definition. In order to allow businesses to comply with and tax authorities to interpret the guidance, and to prevent disputes and potential double taxation, it is important that these features take the form of a clear definition.

The guidance in paragraph 7 states, reasonably, that where ex post profitability departs from ex ante expectations this is an indication of a possible hard-to-value classification, not conclusive evidence. This point should be emphasised so as not to undermine the need for a definition of hard-to-value intangibles.

Arm’s length principle

Paragraph 3 sets out that price adjustment clauses might be adopted by independent parties in cases where ex ante pricing does not prove adequate protection against the risks posed by the high uncertainty in valuing an intangible. This would be on the basis that there would be a contractual adjustment and therefore an upward adjustment for one party matched by a downward adjustment for the other. It is essential that in such a situation the arm’s length principle is applied to intra-group transactions in a way that affords the same symmetry of treatment to group companies. This means that both the upward and downward price adjustments should be respected for tax purposes by tax authorities. The contractual basis for any such approach under the arm’s length principle should allow for deductions on this basis. It would be helpful if the guidance could make this clear.

‘Special considerations’

Similarly, it is essential that any re-assessment of pricing on the basis of ex post information should be afforded symmetrical treatment by both tax authorities without the need for recourse to MAP. MAP (and, where possible, binding arbitration), will remain the most appropriate method for resolving genuine disputes between tax authorities as to the amount of the valuation or the ex post adjustment required.

Exceptions

The proposals suggest that, special considerations will not apply where tax authorities are able to ‘reliably assess’ the information available at the time of the transfer. It is not clear that all parties will share the same views of whether information can be ‘reliably assessed’, and further guidance is required to prevent unnecessary dispute in this area too.

The exception included in paragraph 14 requires ‘satisfactory evidence that any significant difference between projections and actual outcomes is due to unforeseeable or extraordinary developments….that could not have been anticipated….at the time of the transaction’. Further examples of what is considered to be satisfactory evidence of unforeseeable or extraordinary outcomes would be helpful. As a minimum, we would expect this to include macroeconomic developments such as recessions and government actions as well as natural disasters and other forces majeure. The commercial world gives rise to innumerable examples where third party transactions have not led to the results expected for a wide variety of reasons.
2. Comments are invited on whether any additional exemptions should be added to the exemption contained in paragraph 14 of this Discussion Draft. Where additional exemptions are proposed, commentators should explain how the exemption should be framed, considering the aims of the approach set out in the Discussion Draft.

Exemptions in the form of a percentage restriction on the difference between forecasts and actual results should be included. For example, no periodic adjustments should be required if the actual cumulative results related to the intangible are within a range of plus or minus 20% of the forecast results. See comments in section 3 with regard to ‘significant difference’ for further detail.

Exceptions should also apply with regard to the time period to which an ex post valuation should be considered compared to the original transfer. It should be recognised that the passage of time reduces the likelihood of a future event being reasonably predicted. Where price adjustment clauses are found in contractual terms between third parties, these will in almost all cases include a time limit of just a few years during which adjustments are to be made.

3. Comments are invited on whether the notion of “significant difference” in paragraph 13 should be defined, and, if so, what mechanisms could be used to determine whether a difference between the ex ante financial projections and the ex post financial outcomes is significant.

It is important that ‘significant difference’ is defined with sufficient objectivity to prevent dispute. This could be achieved through an appropriate financial threshold based on a range of plus or minus 20% of the cumulative variance from the forecast. A ‘backstop’ measure that caps the absolute difference before adjustment is required could also be considered. A financial threshold represents a clear, mechanical approach that assists all parties involved. It is important that whatever threshold is determined (financial or other) can be applied consistently by both parties to the transaction and by tax authorities.

For completeness, if the difference between the actual results and the forecasts fall outside the specified range, the other exceptions (such as those outlined in paragraphs 13 and 14 of the Discussion Draft or any other) should, if met, still apply.

4. Comments are invited on what further matters would be useful to consider in any follow-up guidance on practical and consistent implementation of the approach.

Price adjustment clause

See Appendix 1. A pragmatic approach for practical and consistent application would be to require related parties to include a price adjustment process in transactions involving hard-to-value intangibles, with such an approach being applied to the results of both parties to the transaction without automatic recourse to MAP. This will require a clear distinction for transactions that would be subject to a price adjustment process and those which would continue to follow the arm’s length principle.

Article 9 of the OECD Model Tax Treaty

The special considerations approach proposed or a price adjustment clause for all intra-group transfers of hard-to-value intangibles would not necessarily reflect the arm’s length principle, so to be effective should be specified as an amendment to double tax treaties.
Transitional arrangements

The Discussion Draft does not make any reference to transitional arrangements. The proposals in the Discussion Draft for special considerations and any mandatory price adjustment clause will be most effectively dealt with via a change to Article 9 of the Model Tax Treaty and bilateral tax treaties, such that changes will apply after the treaties are updated. As such, no transitional arrangements will be required.
**Comments on the Public Discussion Draft**

**BEPS Action 8: Hard-to-Value-Intangibles**

June 18, 2015

Mr. Andrew Hickman, Head of Transfer Pricing Unit  
Centre for Tax Policy and Administration, OECD  
By email: TransferPricing@oecd.org

We are pleased to briefly comment on public discussion draft *BEPS Action 8: Hard-to-Value-Intangibles* (the HTVI draft) through the consultation taking place from June 4, 2015 to June 18, 2015. This document may be posted on the OECD website. Full credit goes to Robert Robillard, DRTP Consulting Inc.¹

According to the OECD, the use of ex post information may be based on the alleged difference between anticipated profits and actual profits (see par. 6, 7 and 14 of the draft). We believe that this method formally institutes a bottom-line driven philosophy to transfer pricing that goes against the arm’s length principle.

From that perspective, the discourse of the HTVI draft reminded us of the argument provided by public discussion draft *BEPS Action 3: Strengthening CFC Rules* (the CFC draft) which was released on April 3, 2015. The argument on the relevance of a “de minimis threshold” found in chapter 3 of the CFC draft is indeed similar to the intellectual foundations motivating the use of ex post information in the HTVI draft. Both cases are misguided with respect to either the arm’s length principle or sound international tax principles wary of not creating double taxation and litigation.

The suggested use of ex post information in the HTVI draft is formulaic in nature. For instance, the methodological approach put forward by the OECD does not take into

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account the fact that the commercialization of any intangible entails significant risks, even more so with HTVI. In other words, multinationals have significant control on their production factors and their supply chain but very little control over the demand factors in any given market. Both sets of factors will affect the final market value of any intangible and, ultimately, the success of their commercialization.

On another issue, we would contend that the exception provided for the use of ex post information in paragraph 14 of the draft is also ill-advised. The fact is that any type of comparability analysis as per chapter I of the OECD guidelines should preclude the necessity of the “OECD approach” with respect to HTVI, according to paragraph 14.

Nevertheless, the wording of paragraph 14 seems to suggest that an “unsatisfactory” analysis would trigger the relevance of the HTVI approach based on ex post results. What may be “unsatisfactory” however remains to be defined. This is indeed a highly subjective notion. On the one hand, this process will create significant uncertainty for compliance purposes. On the other hand, it should be pointed out that what may be “unsatisfactory” for one tax administration will likely be “satisfactory” for another.

In short, encouraging the use of ex post information on the difference between anticipated profit levels and actual results will lead to a significant amount of tax litigation and controversy. Double tax cases should also be expected to rise.

New section D.3 of chapter VI of the OECD guidelines goes against what the arm’s length principle suggests. These rules would be relevant to a global formulary apportionment approach, not for the application of the arm’s length principle.

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Re: Commentary on BEPS Action 8– Discussion Draft on Hard-to-Value Intangibles

Mark Bronson and Mike Heimert; Duff & Phelps, LLC\(^1\)

Dear Mr. Hickman:

We appreciate the opportunity to offer commentary on the OECD’s discussion draft on hard-to-value intangibles (“HTVI”). We certainly understand and appreciate the motivations behind revised guidance for HTVI, however, there are several important matters that need to be addressed relative to this discussion draft. These include:

1. The draft guidance needlessly references a behavioral standard that is unnecessary for purposes of addressing the concerns targeted by this draft;

2. The draft guidance provides exemptions to ex-post adjustments based upon differences between actual and projected results, but the language defining qualifying conditions for those exemptions is too vague, which will lead to non-uniform application of the exemptions and needless uncertainty and controversy.

3. The exemptions provided to ex-post adjustments should explicitly incorporate magnitude-based exemptions. The discussion draft states that potential adjustments should be limited to situations where the difference between actual and projected results is significant, but provides no explicit exemptions that reflect this idea. Furthermore, the exemptions provided to ex-post adjustments should explicitly incorporate time-based exemptions such that if ex-ante projections and ex-post results are within some order of magnitude for an explicit period of time, the projections will be deemed to have met the exemption conditions, and ex-post adjustments will no longer be applicable.

4. We believe that in order to promote certainty and fairness, the discussion draft should contain provisions which bar the opportunity for revenue authorities to

\(^1\) The opinions expressed in this paper are those of the authors and do not necessarily reflect the views of Duff & Phelps as a whole or those of its clients.
repeatedly analyze the question of the adequacy of projections for purposes of qualifying for exemptions.

Each of these comments is discussed in more detail below.

The discussion draft unnecessarily incorporates a behavioral standard that cannot be reliably applied and which is unnecessary

Paragraph 1 of the discussion draft states that “[w]hen valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, the question arises as to how arm’s length pricing should be determined. The question should be resolved, both by the taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in pricing the transaction.”

Paragraph 3 discusses that there might be circumstances where independent enterprises find that pricing based on anticipated benefits alone might not provide adequate protection against the risks posed by the high uncertainty in valuing the intangible. In such cases independent enterprises might adopt shorter-term agreements, including price adjustment clauses in the terms of the agreement, or adopt a payment structure involving periodic adjustment clauses.

The draft guidance is unclear on whether tax authorities may look to third party behavior to alter the transaction that has actually been entered into by the taxpayer. Paragraph 5 states that “[i]f independent enterprises would have insisted on a price adjustment clause, then tax administration should be permitted to determine the pricing on the basis of such a clause.” However, the exemptions in paragraph 14 seem to apply regardless of any such determination. Consequently the role that this behavioral framework is intended to play is unclear.

Furthermore, unrelated parties may or may not, in practice, include contingent consideration in transactions depending upon a variety of characteristics and the extent of any consideration can vary widely across similar transactions. The ability to identify clear patterns in the prevalence of contingent consideration use is highly industry-specific, and in many industries may not be possible. Therefore, the use of an analytical framework that is dependent upon what third parties do with respect to HTVI transactions will not yield clear answers, and the current draft language could be used by tax administrations to inappropriately recharacterize or restructure intercompany transactions through selective evidence that would misrepresent the variation in actual third party behavior.

Furthermore, third party structures for HTVI transactions will vary based upon a wide range of factors – observed behaviors in such transactions are not economic outcomes to address information asymmetry (i.e. the explicit concern being addressed by this draft), but instead risk preferences, bargaining power, cash needs, strategic considerations and other factors
that presumptively should not govern transactions that should be permitted on an intercompany basis.

Therefore, the behavioral framework set forth in section D.1 cannot reliably be applied and is not suited to the problems that this discussion draft is trying to address (i.e. information asymmetry).

**The exemptions set forth in the discussion draft are too broadly defined to allow a common interpretation**

Paragraph 14 provides conditions under which the approach to HTVI described in this draft (i.e. where tax authorities may adjust pricing based upon actual results) will not be applied. These conditions apply when the taxpayer:

1) Provides *full details* of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine price (e.g. probability weighted), and the *comprehensiveness of its considerations of reasonably foreseeable events and other risks*; and

2) Provides *satisfactory evidence* that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.

The three italicized terms above are subject to a wide range of potential interpretations.

The characteristics that might be relevant to determining whether the projections used in a transfer pricing analysis are appropriate (i.e. whether they are of a quality that would be used by independent parties to set a price) is a finite list. The guidance should provide a listing of the important details that taxpayers need to have available with respect to the projections in order to provide greater certainty to taxpayers. "Full details" is too vague.

References to the "comprehensiveness of its consideration of reasonably foreseeable events and other risks" is also vague. In determining pricing and negotiating terms for a transaction involving HTVI, third parties would focus on the most material risks and opportunities associated with the subject intangible. References that make it seem as though all foreseeable events need to be comprehensively reflected create opportunities to inappropriately and frequently deny access to the exemptions.

Finally, "satisfactory evidence" certainly seems to be something that is in the eye of beholder and could easily be abused to make ex post adjustments where none would be warranted. It
may be possible to mitigate this concern by explaining what type of information or characteristics would make the evidence satisfactory.

The exemptions set forth in the discussion draft should incorporate conditions in which projected and actual results are materially similar. Furthermore, if they are materially similar for some period of time, ex-post adjustments should not be permitted after that point.

Paragraph 13 states that "[i]n order to ensure that this approach [i.e. use of actual results to make adjustments to transfer prices for HTVI] is applied only in situations where the difference between ex post outcomes and ex ante projections is significant, and where such a difference is due to developments or events that were or should have been foreseeable at the time of the transaction, its application should be subject to exceptions set out in the following paragraph"

Therefore, it is clear that adjustments should only be applicable if the difference between projections and results is significant. Nonetheless, paragraph 14 doesn’t incorporate exceptions to explicitly reflect this approach. Therefore, there should be an exemption added so that, so long as projected results (as measured by the net present value of sales, operating profits, or some other measure) are with some bound of expectations (for instance, 75% to 125% of projected values) on an actual basis, no adjustments will be made. Projections will obviously never be exactly on target, so providing an exemption for materiality is necessary and prudent.

On a related note, if the projections are “on track” for a certain period of time, that should be sufficient evidence that the projections were adequate for pricing purposes, and the taxpayer should be exempt from future adjustments. For example, this might take the form that, if results are within stated boundaries (for instance, 75% to 125% of projected results) for the first X years following commercialization of the intangible, the taxpayer will not be subject to further adjustments to the intangible transfer price based upon actual results.

The guidance should prevent situations in which tax authorities have multiple opportunities to address these issues for the same subject intangible.

The current draft sets forth a framework where tax authorities can monitor actual results relative to projections, and when there is a (significant?) divergence, determine whether or not the paragraph 14 exemptions apply and, if not, adjust HTVI pricing based upon actual results. This evaluation could take place at any point in time, and under the current guidance, nothing would prevent a tax authority from making this evaluation on an ongoing and regular basis, potentially second-guessing and altering the decisions made earlier on the threshold issues governing whether or not adjustments based upon actual results should apply (or whether exemptions are applicable).
We understand the concerns set forth in paragraph 6 that create disadvantages for tax authorities in evaluating whether reasonable care and consideration governed the construction of projections used for pricing HTVIs, and that the opportunity exists for taxpayers to systematically misprice intangibles as a result. Nonetheless, we think it is reasonable to believe that, over some period of time, tax authorities should be able to evaluate the threshold issues of whether the projections used were of sufficient quality so that ex post adjustments should not be applied based upon actual results. For example, the exceptions set forth in paragraph 14 are something that could be evaluated at any point in time after the transaction’s been undertaken. Leaving this evaluation unbounded by time (and unbounded in number) leaves taxpayers open to unnecessary and counterproductive uncertainty regarding their intercompany HTVI arrangements and tax obligations. Therefore, we would encourage the introduction of language that dictates that tax administrations have a fixed amount of time after a transaction to determine whether or not the exemptions currently set forth in paragraph 14 will apply, and that a determination that exceptions are applicable should mean that they are applicable for all points in the future for the subject intangible.

We are happy to discuss the issues we have raised in this paper in more detail. Please contact Mark Bronson at Mark.Bronson@DuffandPhelps.com or Michael Heimert at Michael.Heimert@DuffandPhelps.com for more information.
European Business Initiative on Taxation (EBIT)

Comments on the OECD Discussion Draft on BEPS Action 8: Hard-to-value intangibles
Dear Andrew,

EBIT is grateful for this opportunity to comment on the OECD’s Discussion Draft on BEPS Action 8: Hard-to-value intangibles (the “Discussion Draft”) dated 4 June 2015. EBIT has a number of concerns with the Discussion Draft which are set out briefly below.

- EBIT Members believe that the special measure proposed for hard-to-value intangibles still seems to be too broad and in an embryonic stage, and in our view needs considerably more work by the OECD to ensure it is in line with the arms’ length principle and ongoing work on BEPS Action Items 8-10, before it can provide objective guidance to MNCs and tax administrations.

- In particular, paragraph 5 of the Discussion Draft departs considerably from the arm’s length standard in that it offers a lot more leeway to tax administrations to ignore or re-characterise almost any transfer of intangibles on the basis of theoretical alternative pricing arrangements independent enterprises might have entered into. This open end and underdeveloped point in the Discussion Draft is a very important point for business and will create significant uncertainty and unpredictability around the overall pricing of intangibles. Also the fact that tax administrations under the proposal will be more easily allowed to re-characterise the transaction based on a mere ex post subjective analysis of whether potential future developments were appropriately weighted by the taxpayer at the time of the transaction, is of grave concern to MNCs. The examples provided in paragraph 15 of the Discussion Draft are not helpful. EBIT recommends that the proposed revisions to the OECD Guidelines focus on providing objective advice to MNCs rather than introducing a re-characterisation measure, which might induce tax administrations to claim the right to use ex post information in almost any situation dealing with intangibles that falls into the overly broad defined category of “hard-to-value” intangibles. Otherwise this could also result in unwelcome fundamental amendments to the existing transfer pricing rules of many countries and a significantly enhanced number of instances of double taxation. We recommend that the OECD also propose appropriate time limits for tax administrations to comply with for invoking the special measure.

- With regard to hindsight, EBIT believes that the Discussion Draft should also take into account the conduct of the parties subsequent to the transfer of the intangible and ensure that tax administrations recognize the respective roles of parties in developing, enhancing, maintaining, protecting and exploiting the intangible when assessing the
EBIT comments on the OECD’s Public Discussion Draft on BEPS Action 8: Hard-to-value intangibles

- differences in *ex ante* and *ex post* profit levels and whether the differences can be traced back to the functions, risks and assets used by the parties to the transaction.

- EBIT has concerns that paragraphs 9 and 10 of the Discussion Draft do not adequately rein in the powers of tax administrations to choose to invoke the use of *ex post* information, nor do they seem to impose an obligation on tax administrations to reach a conclusion in line with the arm’s length principle that is satisfactory to all parties involved as proposed by paragraph 2.11 of the OECD Guidelines. To avoid instances of double taxation, EBIT urges the OECD to make sure the proposed measure meets the arm’s length standard and require tax administrations to guarantee eligibility for the Mutual Agreement Procedure for the resolution of double taxation disputes, which could also fit under OECD BEPS Action 14.

- On the boundaries proposed for tax administrations to observe with regard to the appropriate use of *ex post* information by tax administrations, EBIT Members believe the proposed boundaries in the present Discussion Draft depend too much on subjective notions and whether results were “foreseeable, extraordinary or could have been anticipated.” We urge the OECD therefore to offer more concrete exceptions, e.g. a safe harbour deviation between expectations and results, or a limit to the period in which tax administrations can invoke *ex post* information.

EBIT Members trust that the above comments are helpful and will be taken into account by the OECD in finalising its work in this area. We are committed to constructive dialogue and always happy to discuss.

Yours sincerely,

European Business Initiative on Taxation – June 2015

For further information on EBIT, please contact its Secretariat via Bob van der Made, Telephone: +31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com.

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SUBJECT: DISCUSSION DRAFT ON HARD-TO-VALUE INTANGIBLES

18 June 2015

Dear Dr. Hickman,

By means of this letter, EY would like to share its comments on the public discussion draft on “Arm’s length pricing of intangibles when valuation is highly uncertain at the time of the transaction and special considerations for hard-to-value intangibles” (the Discussion Draft) as released by the OECD on 4 June 2015. We appreciate the opportunity to provide comments and to contribute to the public consultation and discussions about the transfer pricing aspects of hard-to-value intangibles (HTVIs). This letter presents the collective view of EY’s global international tax network.

Key comments

Our key comments with respect to the Discussion Draft, as further elaborated upon in the “detailed comments” section of this letter, can be summarized as follows:

- We welcome the acknowledgement that unrelated parties do agree on payment for HTVIs based on projections, that these projections are inherently uncertain and that an outcome that does not align with the projections does not mean that the valuation or pricing of the HTVI is inappropriate.

- Overall, we believe that the approach as described in the Discussion Draft provides a fairly balanced approach with respect to the treatment of HTVIs. However, we also have a number of concerns regarding the Discussion Draft:

  o The mere fact that a transaction or arrangement between related parties may not be seen in the same form between independent parties does not mean that it should not be recognized as structured. More specifically, tax authorities should not be allowed to easily replace a transaction or include a contingent payment arrangement based on the argument that third parties would have structured the transaction that way.

  o If taxpayers can provide evidence that due diligence is exercised in the financial forecast and price-setting process, the analysis should be respected. Taxpayers should not be asked to prove that differences between projections and actual
results are due to unforeseeable developments and events. Unless the tax authority is able to demonstrate that the assumptions or projections did not take into account important foreseeable developments and events, the projections should be respected.

- Introduction of the suggested approach effectively would lead to the application of contingent pricing arrangements in a wide number of cases, by the tax authority of either the country of the buyer or the country of the seller, depending on the outcome. This would lead to an enormous burden for global businesses and to a significant amount of double taxation in many cases in which no element of base erosion and profit shifting can be found.

- In many countries, particularly developing countries, there is no framework for tax authorities to confirm the arm’s length character of the transaction upfront (e.g., by means of an advance pricing arrangement), or obtaining certainty in advance is difficult and time-consuming. Introduction of de facto hindsight would create significant uncertainties for taxpayers which they could not avoid other than by including contingent payment arrangements in their transactions themselves.

- If the OECD nevertheless were to decide to introduce guidance as currently included in the Discussion Draft, we recommend adding additional objective elements to the definition of HTVI and more detail on the information that a taxpayer would be expected to provide (e.g., regarding the type of information and level of detail that would be required from taxpayers with respect to their projections). We would also strongly recommend the introduction of additional and more effective dispute resolution mechanisms, such as binding arbitration, at the same time.

More detailed comments with respect to the Discussion Draft are presented below. If you have any comments or questions, please feel free to contact any of the following:

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Yours Sincerely,
On behalf of EY

John Hobster / Ronald van den Brekel
Detailed comments
Our detailed comments with respect to the Discussion Draft are presented below, following the structure of the Discussion Draft in terms of sections and headers.

Arm’s length pricing when valuation is highly uncertain at the time of the transaction
The Discussion Draft states that the question of how arm’s length pricing should be determined when valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain should be resolved by reference to what independent enterprises would have done in comparable circumstances. The reference to independent party behavior implies that a taxpayer’s decision on how to deal with the uncertainty (which may be to assume the risk) should be “replaced” with the decision that independent parties would have made. This would mean a re-characterization which, as per existing and proposed guidance in this regard, should only be allowed in specific circumstances. As indicated in the discussion draft on Actions 8, 9 and 10 issued on 19 December 2014, the mere fact that the transaction may not be seen between independent parties does not mean that it should not be recognized. Accordingly, the mere fact that independent enterprises may have included a contingent pricing clause in itself does not mean that related parties should be obliged to do so. If it is possible to price the transaction, tax authorities should refrain from deviating from the transaction “as structured” and the contractual terms agreed upon.

Hard-to-value intangibles
Special measures, such as those described in section D.3.1, should in our view only be adopted for those rare situations in which the arm’s length principle and the existing guidance on the matter fail. However, as crafted, the proposed special measure would apply in many cases in which no element of base erosion and profit shifting can be found.

The special measure suggested for HTVIs is envisaged to apply to transactions involving intangibles as defined in paragraph 9 and 10. While we appreciate that there are challenges (from a transfer pricing perspective) with respect to intangibles for which the value is uncertain at the time of the transaction, we believe that many intangibles will fall within the definition, depending on how tax authorities will deal with highly subjective elements such as “sufficiently reliable comparables” and “reliable projections” and “highly uncertain.” In particular in non-BEPS cases (which are likely to be the vast majority of the transactions involving HTVIs), taxpayers should be protected against the use of such subjective arguments by tax authorities and the uncertainty that comes with such use.

If the OECD nevertheless were to decide to introduce such guidance, we would recommend adding additional objective elements to the definition of HTVIs. We would also strongly recommend the introduction of additional and more effective dispute resolution mechanisms, such as binding arbitration, at the same time.

“The approach”
We fundamentally disagree that the ex post outcomes have any bearing on, or even provide any insight into, the arm’s length nature of an arrangement at the time of the transaction. The Discussion Draft basically states that if the actual outcomes correspond with the expected outcomes, the projections were reliable. This is simply incorrect. The paragraphs as currently worded invite the use of hindsight disguised as a finding that the tax authority has not been able to confirm the reliability of the projection used. For the categories of intangibles identified in the Discussion Draft, there would be, almost by definition, a significant divergence, which under the
proposal would allow tax authorities to apply a contingent pricing arrangement by reference to the suggested approach. It seems fair to say that some tax authorities could be tempted to apply this in situations that are favorable to them. As such, this would lead to a situation of “systematic mispricing” similar to what the Discussion Draft is trying to tackle, except that this systematic mispricing would be after the fact and by the tax authorities. Furthermore, depending on the actual results (compared to the projections), either the tax authority of the buyer or the tax authority of the seller would apply an adjustment.

We propose that paragraphs 11 and 12 be reworded to state that unless the tax authority is able to demonstrate that the assumptions or projections did not take into account important foreseeable developments and events which has resulted in a significant difference between the projections and the ex post outcome, the projections should be respected.

We believe the second condition in paragraph 14 (i.e., that a taxpayer should be required to prove that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events) should not be imposed on taxpayers. The example in paragraph 15 oversimplifies the potential for parties to satisfy this second condition. Suppose for example that one party sells a partially developed active ingredient to a related party and that the price is determined based on a number of scenarios, reasonably taking into consideration the information available at the time of the transaction. For simplicity, let’s assume two scenarios, one of failure of the product and one of success. The probabilities of success and failure are estimated based on past projects and industry experience. Unfortunately (for the buyer), the product fails and therefore the income from the intangible transferred is significantly below the (probability-weighted expected) projections. The fact that there was a possibility of failure was perfectly foreseeable. We believe that if the forecast was made on a sound basis, the tax authority in the buyer-country should not be allowed to adjust the price of the transaction. Similarly, in case of success, the tax authority in the country of the seller also should not be allowed to do so.

Although the introduction in section D.3 indicates that there are a variety of steps that independent enterprises might undertake to deal with high uncertainty in valuation when pricing a transaction, including pricing based on projections of anticipated benefits, this could be interpreted as an indication that independent parties would apply contingent payment arrangements. This does not align with our understanding of independent party arrangements where there truly is a variety of approaches taken. In addition, if the tax authority is able to demonstrate that the assumptions or projections did not take into account important foreseeable developments, this should not by itself allow the tax authority to apply a contingent payment arrangement. At first instance, the tax authority should adjust the price based on the inclusion of the foreseeable developments. Only in exceptional cases, in which such pricing would not be possible, should the tax authority be allowed to reconstruct the transaction, such as changing its economic substance including through the replacement of the existing pricing clause with a contingent payment clause.

*****
June 15, 2015

Andrew Hickman  
Head of Transfer Pricing Unit  
Centre for Tax Policy and Administration  
OECD

BEPS Actions 8 HTVI Discussion Draft

Dear Mr. Hickman,

The partners of FIDAL’s Global Transfer Pricing Services would like to thank you for the opportunity to present our views with respect to the Organisation for Economic Co-operation and Development (“OECD”)’s public discussion draft entitled BEPS Action 8: Hard-To-Value Intangibles, released on June 4, 2015 (the “Discussion Draft”).

General Comments

First, we would like to acknowledge the inherent difficulty in attempting to create guidelines to deal with hard-to-value intangibles (“HTVI”) and we appreciate the tension between not systematically overriding the terms and conditions of transactions involving HTVI and the need for tax authorities to be able to deal with perceived situations of “systematic mispricing”.

Second, it seems to us that the Discussion Draft starts from the premise that the standard applied to HTVI is that there no information asymmetry and no differences in the relative bargaining power between the parties to a transaction. As this is clearly not the case in arm’s length transactions, we believe that this should not be the standard to apply to HTVI in the proper application of the arm’s length principle.¹ What does this mean in practice? It means that, more often than not, arm’s length parties do transfer HTVI between them, based on imperfect projections, and that the terms of such transfers cannot be revisited subsequently by one party or the other even if the actual results obtained differ significantly from the original projections. In other words, we think that the OECD should be careful in suggesting a standard for HTVI which arm’s length transactions could not, in most cases, realistically meet.

¹ Should such a standard be retained, then it should be embodied in a Special Measure.
Third, given the uncertainty of the value of HTVI at any given time and the need for tax authorities and taxpayers to obtain certainty in this respect, we believe that it would be useful for the OECD to affirmatively state that advance pricing arrangements (APAs) are particularly well suited for HTVI and other complex transactions (or transactions involving complex issues) as they allow tax authorities to work with taxpayers and base their views on the same information available to taxpayers at the time of the transaction in establishing acceptable transfer prices.

**Specific Comments**

We have regrouped our specific comments below under the relevant Discussion Draft paragraph numbers.

¶ 1: Accurate Delineation and Non-Recognition of Transactions

As stated in our representations in respect of the OECD’s *BEPS Action 8, 9 and 10: Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures)*, we are quite concerned about recharacterisations/non recognitions occurring outside the exceptional circumstances currently listed at paragraph 1.65 of the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (the “OECD Guidelines”). In our view, this is one of the major problems facing the most recent discussion drafts in respect of the OECD Guidelines as well as the OECD Guidelines themselves: the uncertainty brought about by various approaches which allow tax authorities to disregard the *bona fide* written contracts – which will result, in our view, in a fiscal free-for-all of cases with nearly unresolvable double taxation. The concept of “accurate delineation of actual transactions” is one such troubling approach.

Thus, when at paragraph 1 of the Discussion Draft, one refers to “accurately delineating the actual transaction” and later on to “non-recognition”, this signals that the OECD is still heading in the direction of separating these two concepts and of allowing tax authorities to disregard parties’ written agreements without having to abide by the criteria for recharacterisation/non-recognition. In our view, many, if not all, instances where accurate delineation involves disregarding the terms and conditions of written contracts should be treated as non-recognitions and be subject to the appropriate limitations currently set out at paragraph 1.65 of the OECD Guidelines.

We believe that this is the type of approach that will give rise to more uncertainty, both for taxpayers and tax authorities alike, and that will result in more unresolvable (or extremely difficult to resolve) situations of double taxation.

¶¶ 4-5 Renegotiation and Price Adjustment Clauses

Our overall concern with the proposed ability for tax authorities to impute renegotiations or price adjustments clauses is twofold.

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First, such actions should only be permissible where it is clear that arm’s length parties would either renegotiate or include such price adjustment clauses with respect to their transactions. Second, such actions should be limited by the criteria applicable for recharacterisation/non-recognition of transactions.

The former would involve, in our view, the onus of proof being on tax authorities to demonstrate conclusively that arm’s length parties would have included price adjustment clauses or would have renegotiated the particular arrangement under the same or similar circumstances. Otherwise, this entire exercise becomes a highly subjective action leading to, possibly, analyzing given transactions as if they had been concluded under wholly different terms and conditions – leading us back to our concern expressed with respect to paragraph 1.

We have stated and explained our position on the latter on several occasions\(^3\) and, for the sake of brevity, will not re-state it herein.

\[9\] Definition of HTVI and Presumption on Reliability of Projections

As the proposed definition of HTVI is intrinsically linked to the notion of reliability of the projections of future cash flows or income related to an intangible, and as this criteria of reliability is to be inferred from an ex-post appreciation of how close or divergent the actual results are compared to the impugned projections, we are very concerned that the mechanism proposed in the Discussion Draft imposes on non-arm’s length parties requirements and obligations which are not applied or applicable to arm’s length parties.

As mentioned in our general comments, the projections used by arm’s length parties when arriving at an agreement are seldom, if ever, completely or remotely in line with the actual results subsequently obtained with respect to the relevant intangibles. This, however, is not generally cause of renegotiation or other retroactive change in the negotiated terms and conditions. As such, it seems to us that the requirement that projections related to HTVI be “reliable” is unrealistic and not reflective of arm’s length dealings.

Further, the notion of reliability (and “significant difference”) is inherently imprecise. Does it mean a margin of error of 10%, 15%, 25%, 50%? What is the margin of error of projections used in arm’s length transactions? In our view, this criteria, unless further elaborated upon\(^4\), will simply lead to subjective, perhaps arbitrary, judgement calls as a given tax authority wishes to re-write the terms and conditions of a given transaction involving HTVI, and perhaps the determination itself of whether an intangible is and HTVI.

Finally, the “presumptive evidence” approach resulting from the presumed unreliability of the ex-ante projections seems inappropriate in practice. It should be up to a party to prove its assertions and not for a presumption to be created as soon as a tax authority declares the projections as unreliable. In other words, once a taxpayer has provided his projections for the impugned transaction, tax authorities should

\(^3\) See footnote 2.
\(^4\) Such elaboration would have to tie back to an objective study of the reliability of HTVI-related projections used in arm’s length dealings and, consequently, the establishment of a standard based on these observations.
have the burden of proof to demonstrate that arm’s length parties could not possibly have used the same or similar projections based solely on the information available at the time of the transaction involving HTVI.\(^5\) Keeping in mind our general comment with respect to difference in bargaining power and asymmetry of information, this would mean looking at a given entity and basing that determination solely on the information available to it at the time of the transaction.

In our view, it would be better to abandon the presumption mechanism and simply indicate that any party asserting certain facts or positions should have the burden of proof in establishing those facts or positions.

That being said, we believe that this burden of proof, as it relates to the use of projections should be considered met by taxpayers if the following criteria is also met:

- The projections were prepared ahead of the relevant HTVI transaction;
- The projections were reviewed and approved by either the executive committee or board of the relevant entities involved in the transaction; and
- The projections were included in the Master File in respect of the relevant taxation year(s).

If such criteria are met, then the projections should be regarded as reliable unless tax authorities can demonstrate that such projections would never have been relied upon by arm’s length parties in a similar transaction.

### ¶ 14 Exemption

We welcome the direction taken at paragraph 14. More specifically, we believe that the approach that we have outlined above under paragraph 9 could be used to simplify the test laid out at subparagraph 1 of paragraph 14.

With respect to subparagraph 2 of paragraph 14, we would suggest that, as long as a taxpayer has complied with criteria applicable under subparagraph 1 of paragraph 14 and that the projections thus documented do not mention the developments which led, in part, to the differences between the ex-ante projections and the actual results, then the criteria of subparagraph 2 should be considered as met unless and until tax authorities can demonstrate that such developments were without a shred of a doubt foreseeable at the time of the relevant transaction.\(^6\)

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\(^5\) As indicated at paragraph 18 of the OECD Guidelines: “It would be inappropriate to rely on any of these features, including the burden of proof, to make unfounded assertions about transfer pricing.” See also paragraphs 4.14, 4.16 and 5.2 of the OECD Guidelines.

\(^6\) One must guard against the Chicken Little approach here: one can almost virtually always find someone who has predicted the end of the world and somebody else who would have predicted its opposite. In our view, reliance should be had on industry publications, financing prospectuses, 10-K reports and similar business-related publications rather than one-offs and unsupported statements emanating from non-business authors.
We would be interested in presenting on the delineation/recharacterisation/non-recognition aspects of the Discussion Draft at the upcoming public consultation on July 6 and 7, 2015.

Best regards,

François Vincent  
GTPS Partner  
Pascal Luquet  
GTPS Partner
March 21, 2015

Michelle Levac
Marlies De Ruiter
Mike McDonald
Andrew Hickman
Working Party Number 6
Centre for Tax Policy and Administration
OECD

BEPS Actions 8, 9 and 10 Public Consultation Follow-Up

Dear Michelle, Marlies, Mike and Andrew,

Unfortunately, given the limited time available, the size of the audience and the number of important interventions occurring during some of the public consultations relating to the BEPS project, it is often nearly impossible to fully develop ideas or provide complete answers in respect to certain questions and issues. I am taking the liberty of sending you this note, for sharing amongst Working Party 6 members if possible, to elaborate on and hopefully clarify a couple of my interventions at this past week’s public consultation and to provide some additional comments.

First, let me state that I fully agree with the BEPS project and the intent to eradicate unacceptable tax avoidance schemes and harmful tax practices. I also recognize and appreciate the tremendous amount of work performed by the OECD and WP6 under arguably unrealistic pressure, both politically and time wise. I would ask you to believe that my comments are meant to be constructive and useful in this endeavour.

Importance of Written Contracts

As stated during the public consultation on improving dispute resolution mechanisms on January 23, 2015, I strongly believe that the real end-game with respect to the BEPS project, which will occur after the BEPS project officially concludes around December 2015, is the endeavour by competent authorities to resolve instances of double taxation brought about both by the rules of international taxation as they currently read and by the new rules as changed by the BEPS project.

As the mutual agreement procedure (MAP) programs worldwide are generally already unable to cope with the existing caseloads, it is a safe bet to say that they will be completely paralyzed and unable to perform the task they were assigned if the year-over-year growth of the influx of new MAP requests increases significantly.
There are two ways to counter that increase: either improve the efficiency of the MAP programs or provide a regulatory environment where fewer instances of double taxation are created. While the former can be addressed via mandatory binding MAP arbitration, the latter can be improved via rules that create greater certainty from the outset. This is where the role of written contracts is important.

Written contracts should provide the basis upon which taxpayers organize their affairs and file their tax returns. It should also be the starting point upon which tax authorities audit taxpayers’ tax filings. If, as suggested in the current on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures) (the Discussion Draft), tax authorities do not need to respect ab initio the written contracts of the parties, then the risk and instances of double taxation will greatly increase. This is because some tax authorities will disregard the written contracts and will make adjustments on the basis of imputed transactions that allow them to make the largest transfer pricing adjustment possible. On the other hand, the competent authority who will be asked to provide the corresponding adjustment will respond that it disagrees because, in part, it believes that the transaction as structured by the taxpayer and recognized in its written agreement is the “real deal.”

Sadly, this description of competent authority disagreements in the MAP process is not just theoretical. As stated on a number of occasions, we are already seeing this situation occur as some tax authorities are using the concept of “options realistically available” (ORA) to treat or price transactions as if they are substantially or completely different transactions. The concern here extends beyond the simple issue of creation of double tax cases to, perhaps more critically, MAP cases which are nearly unresolvable. These cases will then start clogging the MAP inventories as competent authorities are unable to resolve them without first agreeing on what is the transaction that they are dealing with, or the real deal.

Some competent authorities have also indicated to me that they would refuse to entertain a case where another tax authority, pursuant to the alleged application of the concept of ORA, would treat a given transaction as a different transaction. This would leave the affected multinational enterprise (MNE) to bear the cost of the double taxation. Therefore, allowing, or inviting, tax authorities to more easily depart from written agreements also brings about serious issues of access to the MAP and, as a result, of relief from double taxation.

Consequently, it is important for the OECD Guidelines to foster an environment where the tax authorities are more likely to be looking at the same transaction when analyzing that transaction both during a tax audit and when endeavouring to resolve double taxation via the MAP.

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7 As defined in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the OECD Guidelines).
8 As that expression was used during the public consultation on March 19, 2015.
9 The classic situation observed in a number of cases involves treating a bona fide license agreement as if it is either a cost-contribution arrangement or a services agreement on the basis that one of the ORAs available to the licensee is to simply cover the on-going costs of the maintenance of the intellectual property being licensed.
10 Or only have local administrative and judicial remedies available – understanding that such local remedies rarely provide full relief from double taxation.
Written contracts, as legally binding instruments, can provide that common basis where such contracts do reflect the real deal. As such, any departure\textsuperscript{11} from the terms and conditions embodied in those contracts, except for a redetermination of prices\textsuperscript{12}, should be subject to severe restrictive conditions and only possible in exceptional circumstances. My understanding is that this is what current paragraph 1.65 of the OECD Guidelines reflects. I would respectfully suggest that this should continue to be one of the foundations of the analysis of transfer pricing transactions.

**Written Contracts and Transfer Pricing Documentation**

If taxpayers want tax authorities to respect their written contracts, it would be only fair for tax authorities to insist on taxpayers obtaining these contracts before entering into transactions (what is commonly referred to as \textit{ex-ante}). It would also be fair for tax authorities to expect MNEs to exercise as much care in drafting and signing such contracts they would with third parties in similar circumstances.

The obligation to include all material intercompany agreements as part of the Local File should then allow tax authorities immediate access to the relevant written agreements at the start of a transfer pricing audit. The absence or incompleteness of such agreements could be specifically referred to as instances where the actual conduct of the parties might or will be invoked to determine the real deal (see the discussion in the section on the Decision Tree below).

In addition to the existing guidance with respect to the Local File\textsuperscript{13}, where the pricing of a transaction, for instance the transfer of a valuable intangible, relies on projections, it might be worthwhile to indicate that such projections and the assumptions underlying them must be specifically spelled out in the transfer pricing documentation and are expected to be attached to the \textit{ex-ante} written contract formalizing such transaction.

**Delineation vs. Non-Recognition**

One of the topics that were not fully covered during the public consultation is the definition of recharacterization/non-recognition and its relationship with delineation. This is what I referred to during the public consultation as the exercise in semantics.

If the proposed structure and wording of the Discussion Draft is retained, then some tax authorities will proceed as they are currently doing in respect of ORA and disregarding, in whole or in part, the \textit{bona fide} written legal agreements entered into between members of a MNE. These tax authorities will then take the position that this does not represent a recharacterization/non-recognition. The concept of ORA

\textsuperscript{11} Departures from the terms of the contracts can arguably take place pursuant to the application of a number of concepts currently contained or proposed to be added in the OECD Guidelines such as recharacterisation/non-recognition, delineation of the actual transaction, ORA and economically equivalent transactions.

\textsuperscript{12} I am referring to the price here as, ultimately, tax authorities look to adjust the price or amount of revenue attributable to their jurisdiction, while Article 9 of the \textit{Model Tax Convention on Income and on Capital} (the OECD Model Convention) refers to the inclusion and taxation of profits.

\textsuperscript{13} The Local File currently requires the inclusion of a summary of important assumptions in applying a transfer pricing methodology as well as a summary of financial information used in applying the transfer pricing methodology. I am simply suggesting to be even more specific as it relates to the transfer of valuable intangibles.
has, in fact, become an invitation for tax authorities to second-guess \textit{bona fide} business decisions and to treat or price given transactions as if the parties had instead entered into a different transaction. The same can surely be expected with respect to the current wording related to the delineation of actual transactions.

In addition, some tax authorities currently treat a transaction as if it was another by changing the pricing mechanism, all the while maintaining that they are simply pricing the original transaction. A real-life example of this is where a tax authority seeks to establish the royalty payable under a licensing agreement based on a cost-plus approach. Licensing of intellectual property is usually remunerated in arm’s length settings by paying a royalty based on a percentage of sales, more often on gross sales but sometimes on net sales. I am not aware of arm’s length parties setting royalty rates based on a cost-plus approach but that does not mean that it is impossible. However, given the unusualness of this approach, I believe it would be fair to insist that tax authorities who seek to take this kind of unusual approach be prepared to prove that arm’s length parties would use such a method of remuneration under the particular MNE’s exact circumstances, rather than a royalty calculated as a percentage of sales.

Consequently, it is important, in my view, to get away from the game of semantics as to whether disregarding is done under the auspices of delineation of actual transactions, of non-recognition of transactions, of changing the pricing mechanism, or otherwise\footnote{Via ORAs, etc.} and instead replace this with a simple rule that would dictate that disregarding all or part of a written legal agreement entered into between the members of a MNE cannot be done unless one meets the criteria applicable for non-recognition. In other words, I think it would be paramount for the OECD Guidelines to clearly state that, notwithstanding any language or concept wherever found in the OECD Guidelines, written legal agreements must not be disregarded, in whole or in part (including the pricing mechanism), unless the criteria of paragraph 1.65 of the OECD Guidelines (or its equivalent provisions in the final re-writing of Chapter 1) are met. The only exception to this being, of course, the ability to disregard the transfer price set by the parties and replace it with an arm’s length amount.

\textbf{When Should Disregarding the Terms of a Written Agreement Be Acceptable}

I believe that disregarding written contracts should only be acceptable in the two sets of circumstances currently covered by paragraph 1.65 of the OECD Guidelines.

First, when the actual conduct of the parties, as discovered through a functional analysis, reveals that the real arrangement between the parties is not the one found in the written agreement. In other words, where the substance of the arrangement contradicts the form of the legal agreement. In such circumstances, tax authorities should be able to say that the written agreement is a sham, or invoke a similar argument, to set the contract aside and analyze the parties’ relationship in light of the true facts.

The second situation seems to be the one that is more problematic as tax authorities struggle with the criteria of commercially rational manner. In this respect, I would suggest that the OECD consider perhaps adopting the criteria that was retained by the
Canadian tax authorities in drafting their rules relating to the recharacterisation of transfer pricing transactions. That is, the criteria retained by the Canadian tax authorities is a dual test which allows recharacterisation if the impugned transaction, or series of transactions:

- would not have been entered into between persons dealing at arm’s length, and
- can reasonably be considered not to have been entered into primarily for *bona fide* purpose other than to obtain a tax benefit.

Perhaps this kind of wording which gets away from the more subjective test of commercial rationality might be more appropriate and enjoy wider acceptance amongst tax authorities.

**Decision Tree**

Bringing all of the comments above together and attempting to address the OECD’s stated intent to invoke the actual conduct of the parties to complement existing written agreements or to contradict such agreements, I would suggest the following approach in addressing the hierarchy of steps in a transfer pricing analysis.

**Step one:** Is the taxpayer subject to transfer pricing documentation requirements?\(^{15}\) If not, then request the contract covering the intercompany transaction under audit and proceed to Step three. If the taxpayer is subject to transfer pricing documentation requirements, then proceed to Step two.

**Step two:** Is the intercompany contract covering the impugned transaction attached to the Local File?\(^{16}\) If not, then the actual conduct of the parties can be invoked and relied upon to determine the real deal. If the contract is attached to the Local File, then proceed to Step three.

**Step three:** Is the contract complete? If not, then the actual conduct of the parties can be relied upon to complement, not contradict, the existing terms and conditions of the contract – in other words, to infer those clauses that should have been included in the contract but were missing. If the contract is complete, then proceed to Step four.

**Step four:** Does the actual conduct of the parties, established through a functional analysis performed during a tax audit, correspond to the terms of the contract? If not, then, there may be a need for non-recognition as the form does not match the substance of the transaction. Minor digressions from the terms of the contract, such as paying invoices within 45 days instead of 30 days, should not open the door to non-recognition but, rather, could result in an adjustment to the transfer price. If the conduct of the parties corresponds to the terms of the contract, then proceed to Step five.

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\(^{15}\) In some jurisdictions, taxpayers are only required to prepare transfer pricing documentation if certain thresholds are surpassed.

\(^{16}\) If the impugned transaction does not constitute a material transaction, then there is no obligation to attach the contract covering this transaction to the Local File. Thus, I am proceeding with the decision tree on the assumption that we are dealing with material transactions.
Step five: Are the criteria for the second exception allowing non-recognition met? 
If not, then disregarding the terms of the contract in any manner whatever or pricing the transaction as if were a different one is not allowed under any circumstances. The only action which is allowed is to reallocate the profits from one party to the other in accordance with the arm’s length principle. If the criteria are met, then there may be need for non-recognition of the impugned transaction.

I have illustrated this decision tree in the appendix attached to this letter.

I hope these comments can be useful in the difficult endeavour ahead of you.

Best regards,

François Vincent
GTPS Partner

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17 Either as those criteria are currently laid out in paragraph 1.65 of the OECD Guidelines (criteria of commercially rational manner) or as ultimately amended by the OECD – see my suggestion above.

18 As stated above, whether disregarding is done as a delineation of actual transactions, as an application of the concept of ORA, as a formal non-recognition, or in any other manner.
**APPENDIX: DECISION TREE**

**Step one:** Is the taxpayer subject to transfer pricing documentation requirements?

*No*

Request contract covering the intercompany transaction under audit and proceed to Step three.

*Yes*

**Step two:** Is the intercompany contract covering the impugned transaction attached to the Local File?

*No*

The actual conduct of the parties can be invoked and relied upon to determine the real deal.

*Yes*

**Step three:** Is the contract complete?

*No*

The actual conduct of the parties can be relied upon to complement the existing terms and conditions of the contract.

*Yes*

**Step four:** Does the actual conduct of the parties correspond to the terms of the contract?

*No*

There may be a need for non-recognition of the transaction as the form does not match the substance of the transaction.

*Yes*

**Step five:** Are the criteria for the second exception allowing non-recognition met?

*No*

Disregarding the terms of the contract in any manner whatever or pricing the transaction as if were a different one is not allowed under any circumstances.

*Yes*

The transaction may be disregarded and priced accordingly.
Comments on the Public Discussion Draft of BEPS
Action 8: Hard-to-value Intangibles

For the attention of Mr Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration, OECD.

Introduction

The OECD released its latest public discussion document on 4 June 2015 with proposed updated section of Chapter VI of the OECD Transfer Pricing Guidelines. Comments are invited by 18 June 2015. The comments provided below are prepared by the author as representative of Gazprom Marketing & Trading Ltd.

Background

We took the opportunity to respond to the discussion document issued in July 2013 on proposed revisions to the OECD Guidelines (Chapter VI). These comments reinforce our comments made at that time.

Concerns and observations

We note that, as with other discussion drafts arising from the BEPS initiative this is a non consensus view. Given the fundamental and wide reaching nature of the BEPS programme we find this troubling. The avoidance of double taxation is a key principle of international taxation supported by the application of the logical and well understood rules of arm’s length pricing. This approach promotes international trade and aims to make sure that there is equitable, consistent and symmetrical treatment of taxpayers by the respective tax authorities involved. This equity of treatment relies on the consensus and consistent approach of the authorities involved.

We are concerned that if those same authorities cannot reach consensus in developing proposals for change then the likelihood of uncertain and conflicting treatment being applied by tax authorities on subsequent application of any changes to the rules is significantly increased.

Uncertainty over valuation and arm’s length pricing

The proposed updated guidance states that where the valuation is highly uncertain at the time of the transaction, then independent entities use a variety of mechanisms to manage this risk, in order to reach a mutually acceptable basis on which to proceed with the transaction. Examples of such mechanisms include the term of the agreement, meeting milestones or performance measures.

However for an agreement to be concluded each party will assume certain risks and then be bound by the consequences of those risks – this acceptance of risk and reward is fundamental to commercial operations.
The draft suggests that because it is difficult for tax authorities to assess the commercial risks then they find it hard to assess appropriate pricing. We would suggest that it is equally hard for taxpayers to assess the risks. Forecasts and expectations are uncertain but commercial decisions are made and risks accepted nevertheless.

**Special considerations where valuation is considered difficult**

The proposed updated guidance suggests that where intangibles are hard to value, special rules should apply and proposes that tax authorities should be able to use actual outcomes to identify where prior pricing was “wrong”.

This is fundamentally at odds with what happens in the real commercial world, where the measured assessment and acceptance of risk together with its consequences – profits or losses, define the success of business transactions. Independent parties don’t usually get the opportunity to revisit agreements and seek compensation from counterparties.

A robust application of the arm’s length principle and justification of appropriate pricing consistent with this principle should adequately address the risk / reward balance between connected parties.

Adoption of a process which allows the tax authorities to, in effect, opt out of assessing the transaction and then to simply await the outcome, exposes taxpayers to uncertainty, potential double taxation and additional compliance costs.

Finally, we would add that virtually all intangibles are hard to value when compared to other property such as real estate or shares.

**Implementation**

We understand that tax authorities find assessing values of certain assets difficult, they are not alone! We do not consider that this is enough to adopt an entirely new ex post assessment of tax liabilities. We would therefore urge that these rules are not adopted.

However, in the event that the proposed guidance (or something similar) is implemented, then it is essential that the scope for uncertainty or differences in interpretation of the rules is minimised. In particular we consider it vital that the following areas are addressed:

- Clear definition of which intangibles and / or factors could give rise to potential ex post assessment, should actual outcomes prove to *materially* outside expected parameters.
- Only if an intangible is of the type considered to be in the “hard-to-value” category, then a definition of boundaries at which there was considered to be a difference of *sufficient significance* to warrant tax authorities seeking further evidence of pricing.
- Clarity that just because an intangible is considered “hard-to-value” and returns were outside boundary conditions, then there is no presumption that pricing was inappropriate. Taxpayers should have a realistic expectation that if they can show, based on evidence and facts *at the time*, that the pricing was consistent with the arms length principle (given the risk / rewards genuinely assumed by respective parties) then the original pricing should stand.
• The provision of evidence of no tax avoidance motive or a purely commercial motive for the transaction, and the pricing adopted should provide a sufficient rebuttal of any assessment based on ex post returns.

• Symmetry of treatment and dispute resolution by tax authorities. It is essential that interpretation of when any special provisions might apply, adoption of any consequential adjustments and treatment of profits and losses arising should be symmetrical in all the jurisdictions concerned. This should apply and be enforceable without the need to instigate Treaty mutual agreement processes. This is complicated by the fact that any period of adjustment could be significant and may well extend outside of domestic rules on statute of limitations.

Concluding remarks

In addition to the comments above we welcome the fact that the proposals do not go so far as to include a blanket requirement for a price adjustment clause in all connected party transactions.

Many assets are hard to value including most intangibles. This difficulty is faced by taxpayers and tax authorities alike. Commerce addresses this issue through the terms and conditions of contractual arrangements. We believe that the arms length principle, if properly applied is sufficient to address these difficulties without the need to resort to the use of hindsight. Facts and circumstances at the time (including reasonable expectations of the future) should govern pricing decisions.

The use of valuation specialists to assess and justify valuation outcomes helps control the risk in any transaction but cannot eliminate all risk. It is the assumption of risk and the potential for reward that drives commercial operations, resorting to taxation on a basis that is not consistent with the underlying commercial position gives rise to uncertainty, cost and the potential for double taxation on taxpayers.

These comments have been prepared by:

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FRANCE

17 June 2015

Dear Mr Hickman,

OECD public discussion draft - BEPS Action 8: Hard-to-value Intangibles (HTVIs)

Grant Thornton International Ltd welcomes the opportunity to comment on the OECD public discussion draft entitled BEPS Action 8: Hard-to-value Intangibles (HTVIs), issued on 4 June 2015. We appreciate the work that the OECD has undertaken on the revised chapter VIII and would like to make the following comments on the public discussion draft.

In many ways how to deal with HTVIs is the critical issue for the BEPS project. We appreciate that the BEPS project is closing in on a deadline but we are disappointed that public comments have been invited within a 14 day deadline. Such a short comment period limits full reflection of the issues raised particularly given the views and proposals do not yet present a consensus view of the CFA or its subsidiary bodies.

There are some tangible assets which are also hard to value, and on grounds of consistency the principles in this discussion draft should also be applied in those circumstances. We would therefore support section D3 being retitled more generically "Hard to value assets".

Proposed section D.3. Arm’s length pricing when valuation is highly uncertain at the time of the transaction

Mechanisms adopted by independent enterprises to protect against the risks posed by the high uncertainty in valuing the intangibles that could be adopted by related entities

We observe that paragraph 1 of the Discussion Draft suggests the arms’ length pricing should be resolved "by reference to what independent enterprises would have done in comparable circumstances".

The discussion draft indicates that independent enterprises might adopt shorter-term agreements, include price adjustment clauses in the terms of the agreement, or adopt a payment structure involving periodic milestone payments to protect against subsequent developments that might not be sufficiently predictable.

Comment:

In our experience, HTVI are often created in the research or early development stage of new products or ventures. By their nature, and as alluded to in Paragraph 10 of the Draft, the derivation of future income from the HTVI can be highly uncertain and often requires considerable further expenditure (by way of further development and/or the commencement of sales and marketing activities) before the success, or otherwise, of the asset will be determined. Accordingly, the primary risk taker in a transaction for the
transfer of a HTVI or rights in that HTVI is usually the entity providing the capital, the acquirer. Therefore, on an arm's length basis, once transferred, the transferor relinquishes the majority of the rights to future profits from the exploitation of the HTVI. Hence it is not always the case that uncertainties are dealt with via adjustment clauses or similar means. They are often dealt with as part of the valuation exercise to set the price and terms at the date of the transaction, often with the inclusion of a high discount for risk of failure.

The suggestion in Para 2 and 3 of the Draft that flat prices are paid only where outcomes are "predictable" is not the case in many third party situations. Stepped royalty methodologies are often seen in licence agreements for intangibles between unrelated parties. Furthermore, it is not uncommon for contracts for the sale of businesses including intangible assets to include "earn out" clauses or payment terms including contingent amounts that would become payable only on the achievement of specified milestones, usually in the form of profit thresholds. However, it should be acknowledged that these agreements represent the negotiated position of the value and basis for consideration between a willing buyer and willing seller at the time of the agreement and would not typically be renegotiated for ex-post information.

As outlined in paragraph 4 of the Draft, we recognise that companies acting at arm's length may sometimes seek to renegotiate onerous agreements in accordance with contractual "break" clauses. The example provided is where royalties under a product IP licence agreement are set at a level that does not enable the licensee to trade profitably. At this stage, the intangible asset subject to the agreement is unlikely to be classified as a HTVI as income streams should be reasonably certain. We consider arm's length behaviour in these circumstances would include a range of outcomes covering:

- accept the royalty arrangement until the end of the term;
- terminate the agreement and walk away; or
- renegotiate a royalty rate for future periods, but not for past years.

Hence any review should not allow or give credence to tax authorities re-assessing the arms' length nature of any earlier transaction relating to the intangible whilst it was classified as a HTVI. It is not appropriate to use ex-post information to reconsider and reset ex-ante pricing decisions.

The principle of arm's length pricing works well in practice when there are comparable circumstances, including transactions in similar assets of a similar volume undertaken between independent willing parties. It is more difficult if not impossible where there is no established market of similar transactions, or the asset is close to being unique. In such circumstances it may be most efficient for the enterprise to engage an independent professional valuation expert. Section D3.1 should be explicit in this regard.

It is worth clarifying the meaning of comparable circumstances. This should include at least similar knowledge of the asset and the wider business sector; core businesses of the contracting parties are at similar stages of development; operating in similar business environments in the relevant economies; facing similar operating risks and with similar risk appetites.

**Special considerations for hard-to-value intangibles (HTVI)**

The Discussion Draft suggests that there may be a need for special considerations to be adopted by tax authorities when dealing with the transfer of HTVIs. Such assets would include those where, at the time of their transfer between group companies: (i) no sufficiently reliable comparable data exists; and (ii) there is either a lack of reliable projections of future cash flows or income expected to be derived from the transferred asset, or the assumptions used in valuing the asset are highly subjective and therefore uncertain.
In this respect, the Draft proposes that tax authorities may use ex post evidence about financial outcomes in years subsequent to the transfer to determine whether a price adjustment is necessary, and where changes from forecasts are not linked to identifiable external factors.

Comment:

There will be challenges in determining when the arm's length principle will continue to apply and when the special considerations should be taken into account.

Additionally, the Draft indicates that special considerations will not apply where tax authorities are able to "reliably assess" the information available at the time of the transfer. It remains to be seen whether multiple tax authorities that review the same transactions will agree on whether information can be reliably assessed.

As noted above, in third party situations there is often high uncertainty. We are very concerned that tax administrations will seek to argue that:

i either taxpayers had exploited asymmetry of information when the taxpayer did not know or could not reasonably have foreseen the outcomes; or

ii taxpayer projections must be perfect in order to escape the use of hindsight;

There will be asymmetry of outcome as ex ante information is not perfect. It may be tempting for tax authorities to use ex post information when values go up but not when they go down.

Given that "hope value" is not achieved in many third party deals but can be significantly exceeded in others (the "blockbuster" intangible), this is a real and serious concern. By way of example, the London Financial Times of 16 June 2015 reported four experimental or development drugs sold by GSK to third parties which have subsequently significantly increased in value.

Accordingly, we are concerned with the implication of using hindsight. In the context of valuations in business acquisitions, we understand for example that the UK courts are unlikely to accept the application of hindsight. The UK Courts have indicated that a valuation should be based on the facts and outlook at the valuation date and hindsight should not be used as a sense check of assumptions at the valuation date. Looking back and judging likely outcomes with the benefit of hindsight has the potential to misstate values at the time decisions were taken because hindsight could under/overestimate estimate perceived risks attached to the businesses/investments at that time.

This is on the basis that business management should be able to assess, with reasonable certainty, reasonably predictable events within a reasonable future time window but cannot have the necessary "perfect" market information to make reliable valuation and pricing decisions beyond that time frame.

Accordingly, when assessing the arm's length pricing for a HTVI, tax authorities should not be allowed to apply ex post evidence about financial outcomes beyond a short time window. The onus in paragraph 14(2) is that the taxpayer should "provide satisfactory evidence that any significant differences… could not have been anticipated at the time of the transaction". We consider that if the taxpayer has provided details of its ex ante projections, risk assessment and its consideration of reasonably foreseeable events and risks as set out in paragraph 14(1), or has relied on an independent professional valuation, then the onus should be on the tax authority to demonstrate that these assumptions did not reflect the economic or commercial facts and circumstances at the time of the transaction. For this reason, we suggest the application of ex-post evidence by tax authorities (paragraph 12) should not be considered beyond a limited period, say, of 12 months from the date of the transaction.
We would welcome a recommendation from the OECD on a unilateral or bilateral advance clearance procedure for HTVI transactions. Such a clearance procedure could enable the ex-ante assumptions to be reviewed at or shortly after the date of the transaction and provide greater certainty for both taxpayers and tax authorities.

Use of ex post outcomes
D3.1 paragraph 11 says "...[verifying the arm's length basis on which pricing was determined] will prove difficult for a tax administration...until ex post outcomes are known". Section D3.1 paragraphs 12-15 infer that using ex post outcomes is the only or preferred solution, because paragraph 14 describes exemptions when this approach will not apply.

Comment:
As paragraph 13 says, this solution introduces additional judgement into an issue which is already subjective. Whether developments or events were or should have been foreseeable will likely be different when viewed from one perspective or another.

We do not believe that ex post factors should be used. However, if they are retained as an option in section D then section D3.1 should be rewritten to explain that ex post outcomes are the exception to be used only when all other avenues have been explored but have nevertheless not provided an appropriate solution. Other methods include those described in paragraph 14, and use of an independent professional valuer. It should also be explained that paragraph 14 is not an exhaustive list of acceptable methods for assessing the basis on which pricing was determined.

Intangibles falling within the category of HTVI
The Draft proposes that the assets falling within the category of HTVI may exhibit one or more of the following features:

- Intangibles that are only partially developed at the time of the transfer
- Intangibles that are not anticipated to be exploited commercially until several years following the transaction
- Intangibles that separately are not HTVI but which are connected with the development or enhancement of other intangibles which fall within the category of HTVI
- Intangibles that are anticipated to be exploited in a manner that is novel at the time of the transfer.

Comment:
International Financial Reporting Standards (IFRS) address the recognition and valuation of assets for financial reporting purposes. Reference to IFRS in the Draft will provide a more comprehensive explanation of the aforementioned features as well as additional examples. This would help reduce differences in tax and accounting treatments and prevent disputes and potential double taxation issues due to different tax authority interpretations.

Notion of "Significant difference"
The discussion draft states that the use of ex post evidence about the financial outcomes by tax administrations should ensure that the approach is applied in situations where the difference between ex post outcomes and ex ante projections is significant.

Comment:
We consider that it is difficult to quantify "significant" by reference to financial measures due to the extensive range of industries and economies in which HTVI are developed and traded. For example, a HTVI in the pharmaceutical industry is likely to have a very different risk and economic profile to one,
say, in the industrial sector and thus the relative "significance" is likely to be markedly different. Accordingly references to significance in paragraph 13 should be removed. Additionally, special considerations are only applied in circumstances where developments or events should have been foreseeable at the time of the transaction but not taken into account in the ex ante assessment.

We would rather that the draft replace "significance" with the concept of "materiality". Materiality is a widely understood concept, and would also promote greater harmony between tax and accounting treatments.

Additional points
In addition to our prior comments on the proposed guidance in the Discussion Draft, we comment below on the additional points raised.

Question 1: Comments are invited on whether there are mechanisms that could be adopted to provide greater certainty for taxpayers regarding the application of the approach to HTVI.

Comment:

We support a process whereby agreement on tax treatment can be sought at or around the time of the transaction. This would eliminate the potential for ex post considerations inadvertently impairing the judgements of the contracting parties or the tax administrations.

Question 2: Comments are invited on whether any additional exemptions should be added to the exemption contained in paragraph 14 of this Discussion Draft. Where additional exemptions are proposed, commentators should explain how the exemption should be framed, considering the aims of the approach set out in the Discussion Draft.

Comment:

If the company uses an independent professional valuer to help it arrive at an ex ante price then that should be an exemption to the approach described in section D3.1. Such an exemption could be phrased as follows: "...provides an ex ante independent professional valuer’s report prepared to generally recognised valuation standards such as those published by the International Valuation Standards Council, together with instructions to the valuer."

Question 3: Comments are invited on whether the notion of "significant difference" in paragraph 13 should be defined, and, if so, what mechanisms could be used to determine whether a difference between the ex ante financial projections and the ex post financial outcomes is significant.

Comment:

We prefer the concept of materiality. However, if the principle of significant difference is retained, then the principle itself is sufficient, and should not be further defined.

Question 4: Comments are invited on what further matters would be useful to consider in any follow-up guidance on practical and consistent implementation of the approach.

Comment:

We would welcome the inclusion of more examples including several where the pricing would not be revisited.
If you would like to discuss any of these points in more detail then please contact either myself or Wendy Nicholls, Partner, Grant Thornton UK LLP (Wendy.Nicholls@uk.gt.com; M: +44(0)7714 069862).

Yours sincerely

[Signature]

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Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles

Dear Andrew,

GSK welcomes the opportunity to provide comments on the discussion draft. In our response we have focused, in particular, on how best to provide greater certainty to taxpayers in the application of the proposed approach. The over-riding theme underpinning our submission is that the approach is likely to be employed only when ex post outcomes have, in fact, diverged from ex ante projections. The practical challenge for both taxpayers and tax authorities is, therefore, to be alive to the danger of applying hindsight, whether consciously or subconsciously. When a particular event has, in fact, occurred the natural tendency is to assert that it was more predictable than the parties may have considered at the time. We welcome the clear statements against the use of hindsight, in paragraphs 7 and 12 in particular, but are nevertheless concerned that those statements may be given insufficient weight in practice.

Price Adjustment clauses and re-negotiation

In our experience, in our sector price adjustment clauses (as distinct from a payment structure with defined milestones or royalties) are agreed between independent enterprises in a relatively narrow set of circumstances. Typically they will operate by reference to the outcome of a specific and clearly defined event, which is anticipated - with some degree of certainty - to take place in the fairly near term (typically months rather than years), and where the parties are aligned in their view of the impact which the outcome would have on the valuation. Although the exact outcome is uncertain, the nature and timing of the event, and the range of possible outcomes, must be capable of being clearly described in the agreement, such that the application of the clause does not become a matter for dispute. In our view, the wording of paragraph 5 creates a risk that tax authorities will assert that a binding price adjustment clause should have been included to deal with uncertainties in valuation which, commercially, would not be dealt with in that way.

We also feel that paragraphs 4 and 5 risk conflating the separate approaches of a contractual price-adjustment clause on one hand (where, almost by definition, a change in facts was anticipated even if the outcome was not), and a commercial re-negotiation (outside the terms of the contract) based on an unforeseen change in facts.

Turning to consider a prospective renegotiation, we agree that at arm’s length the licensee in the example in paragraph 4 might seek to renegotiate the terms, as on the facts set out it has become uneconomic to proceed with the current pricing. If the licensor feels that no alternative counterparty could be found at that price (for example, an alternative manufacturer with a lower cost base or an innovative process may still be able to make money operating the licence on those terms) then the licensor would similarly be incentivised to renegotiate.

However, there are a number of commercial situations where (perhaps due to a new market entrant as in the example) one party or the other feels they have got a bad deal, and may even be making a
loss, but nevertheless no renegotiation occurs. The intangible may have been transferred as part of a portfolio, and both parties may feel they are content with the outcome across that portfolio. One party may decide not to propose renegotiation because of a desire not to impact the broader commercial relationship between the parties, or it may be that no agreement can be reached (perhaps due to the relative negotiating positions of the parties). In our view, therefore, a lack of variation of an agreement is not necessarily indicative of mispricing. Although this can be inferred by the section in parentheses at the end of paragraph 4, we suggest that the text should make this explicit.

Perhaps more pertinently - given that a tax authority is most likely to seek to apply the HTVI methodology when a drug has done better than expected rather than worse – a licensor may find that even though the licensee has got a larger share of the profit “pie” than might have been anticipated at the time of the transfer, because the pie is larger the licensor is sharing the upside. This may be through increased sales-based royalty payments (due to increased sales rather than to a change in the agreed royalty rate). Between related parties, the HTVI methodology would require this divergence between ex ante projections and ex post outcomes to be explainable with reference to events unforeseen at the time of the transfer. Provided this can be done, we would suggest additional language in the text to make clear that a tax authority should not automatically assert that pricing can nevertheless be revisited just because one party was doing better than expected compared to the other. Otherwise, in practice, a taxpayer would be at risk of challenge even when ex ante projections were comprehensive, simply because ex post outcomes turned out better than expected.

**Milestones and royalties**

We agree that payment structures including milestone and royalty payments are common between independent enterprises, and provide an effective way for parties to a negotiation to “bridge the gap” between their respective valuations. However, we feel that the text should acknowledge that at arm’s length independent enterprises do, in some cases, agree prices for hard to value intangibles without such a contingent payment structure – and that (in limited circumstances) such pricing is appropriate between related parties. Typically – though not always - the circumstances would be linked to a decision by the disposing party to de-risk, such that it is not desirable to have an ongoing exposure to uncertain future events.

Where it is possible to demonstrate that parties at arm’s length would not have entered into contingent pricing arrangements by reference to the facts and circumstances of the arrangements, then the actual pricing should not be replaced with contingent pricing. For example, suppose that sales of a product in Europe have become commoditised as a result of the availability of generic alternatives. A decision is made by the IP owner to withdraw that product from Europe as it is no longer possible to sell the product at a profit. The product is not currently sold outside of Europe and in particular is not available in certain emerging markets. Group expertise in relation to the development and exploitation of products for emerging markets are based in Country X. The success of product X in emerging markets will be dependent upon many factors which are outside of the control and expertise of the existing IP owner. The existing IP owner therefore wishes to enter into an outright sale of the IP in relation to the product to enable it to focus on its remaining core and pipeline portfolio for the European market. Entrepreneur located in Country X is confident, based on its track record of successfully adapting products which have become commoditised in Europe for sale in the emerging markets, and would prefer to acquire the IP outright. This is also in part due to exchange control restrictions that would make a deferred consideration arrangement difficult to operate commercially.

Other examples might include a purchase from private equity, a purchase from a start-up with a single asset, a strategic decision to exit from a business area, or a decision by the directors of a company to move from being an at-risk entrepreneur to a contract service provider.
We also note that in some sectors, including pharmaceuticals, a body of public data is available showing typical success rates of intangible assets at different stages of development. This is likely to mean that at arm’s length, parties may be more likely to reach agreement on an “up front” price without milestones or royalties. In such a situation, the absence of milestones or royalties should not necessarily be a trigger for tax authority to assert non-arm’s length behaviour.

**Ex ante projections versus ex post outcomes**

We agree that divergence between forecasts and outcomes may be indicative of systematic mispricing of the type described at paragraph 6. However, we are concerned that paragraph 7 makes reference only to “unforeseeable” events. Given, as set out above, that this test will be applied in practice only when there is, in fact, a divergence, “unforeseeable” appears to us to set a very high bar.

For example, an “unforeseeable” event – one which could not have been foreseen - appears to set a higher bar than an “unforeseen” event – one which was not, in fact, foreseen. Even a highly improbable event is arguably foreseeable in the right circumstances. A taxpayer who has not, in fact, foreseen such an event will struggle to argue that this failure was not due to a lack of rigour when the improbable event has, in fact, occurred. The draft appears to use these terms as to some extent interchangeable (“unforeseeable” at para 14; “unforeseen” in the examples at para 15 of natural disaster and bankruptcy) when they appear to us to be different tests.

In any event, we consider that “unforeseen”, itself, sets too high a bar. A number of potential scenarios may have been foreseen, considered, and then disregarded as sufficiently remote to directly impact pricing. So long as this decision was appropriate, the fact that the event was foreseen should not prevent it from being subsequently adduced by the taxpayer to explain a divergence from forecast outcomes, in the event that it did, in fact, occur.

We consider that the phrase “extraordinary”, used in paragraph 14(2), captures the test which should be applied more accurately than “unforeseeable”, and that the words “reasonably” or “commercially” should be used to qualify the phrase “could not have been anticipated” later in that same paragraph – in the same way that “reasonably foreseeable” is used in paragraph 14(1).

**Definition of Hard-to-Value Intangibles**

While recognising the challenge in defining the term HTVI, we are concerned at the concept of there being a “lack of reliable projections”. As above, if this is being applied in practice only once it is clear there is a divergence in ex post outcomes, there is a natural tendency to look at the projections and to assert that they were not reliable. This may lead to tax authorities seeking to apply the HTVI definition to a broader range of transactions than we believe is intended. We acknowledge the statement in the last sentence of paragraph 9 that, to some extent, this is intended – ex post information provides presumptive evidence of how reliable projections were. However, we suggest that it should be made clearer that this should only be a starting point.

Our observations in this area are closely linked to the following section on what might constitute a “significant difference” between ex ante and ex post numbers.

**What is a “significant difference”***?

In many sectors, particularly those with long product cycles, the commercial forecasting which forms the basis of a valuation is particularly uncertain, and (despite best efforts) eventual outcomes are often materially different. It may not always be possible to point to specific “unforeseen” events to explain the divergence – or such events may only account for some of the difference. However, under the proposed approach, in a situation where ex ante and ex post numbers diverge there seems to have been a potential shifting in the burden of proof whereby the taxpayer is potentially required to
reconcile forecasts to actual. This will be more challenging in a sector where forecasts are inherently more uncertain.

As well as a range of safe harbours, which should be set at a level appropriate to account for “usual” industry divergence, we suggest that a concept of motive could be introduced. This could apply where the taxpayer can demonstrate that the anticipated commercial benefits from sale of the HTVI are significant in comparison to any tax benefit in the transferor and transferee jurisdiction. In such a situation, and in the absence of other factors, an ex post divergence from forecast might not create a presumption that the transaction has been mispriced.

Other matters

We suggest that a number of administrative measures could be introduced by tax authorities to provide greater certainty. For example:

- Fast-track clearance for disputes - as the transfer of the intangible may fall within capital rather than income provisions in one or more territories, any disagreement over pricing would fall outside of the normal treaty agreement procedures. We recommend a specific valuation clearance process for HTVI that can apply regardless of capital or income treatment in one or more territories.

- It would be helpful for the text or commentary to make reference to the interaction with advance pricing agreements. The pricing of royalties on an intangible would be a typical transaction to cover in an APA. We believe there should be a presumption that where an APA has been agreed, as part of which process the valuation would have been closely scrutinised by the tax authority, that tax authority should be prevented from subsequently utilising the HTVI methodology. It may be also helpful to introduce the option of making an advance agreement with the tax authorities as to when an asset being transferred is a HTVI, in which case it may be appropriate to compare the ex post outcomes and ex ante projections, so as to limit the instances where the tax authorities may challenge the value.

- We suggest some time limit being imposed on the ex post outcomes – removing the incentive for tax authorities to seek to leave audits open for several years.

I would be happy to discuss any of the above if you would find it helpful.

Yours sincerely,

Melissa Geiger
SVP Global Tax, GSK
melissa.j.geiger@gsk.com
June 16, 2015

To:
Mr Andrew Hickman
Head of Transfer Pricing Unit
Centre For Tax Policy Administration
OECD

By Email to: TransferPricing@oecd.org

Re: Comments on Public Discussion Draft: BEPS Action 8: Hard-To-Value Intangibles, June 4 – 18, 2015

We respectfully present our comments on the above Discussion Draft.

We are an accountancy firm keen to see reasonable tax paid without harming bona fide businesses.

**OECD Proposals in a Nutshell:**

The BEPS Action 8 Discussion Draft refers to under-disclosure by taxpayers as "information asymmetry". The OECD discusses the desirability of short term agreements, price-adjustment clauses, milestone payments and even re-negotiation of contract pricing terms.

But can a tax authority deem these to exist when they don't?

The OECD says special considerations exist in the case of various under-developed "hard-to-value-intangibles"

In such cases, the OECD recommends letting tax authorities make hindsight adjustments to determine arm's length pricing arrangements, if there are "significant differences" between the original "ex ante" predictions and the subsequent "ex post" outcomes.

However, no hindsight adjustment would apply where the taxpayer:

- Provides full details of its original projections, including how risks were accounted for (e.g. probability-weighted) and how it considered reasonably foreseeable events;
- Provides "satisfactory" evidence that any significant difference was due to unforeseeable or extraordinary developments, e.g. natural disaster or unexpected bankruptcy of a competitor.
Comments:

Following are our comments on the BEPS Action 8 discussion draft:

- The question of whether to allow tax authorities to use hindsight is important in all areas of the global economy, not only hard-to-value intangibles transferred between related parties. The final recommendations should be made more generally applicable to taxation.

- The OECD has indicated that for tax purposes, value should be attributed to where it is generated. The draft report apparently makes no mention of this.

- The term "significant" differences is vague and should be clarified. Otherwise, tax authorities make mountains out of mole-hills.

- The term "satisfactory evidence" is also vague and should also be clarified.

- The main problem is uncertainty, the tax stakes are massive. The solution would be to have a safe harbor.

  - We recommend letting taxpayers prepare at the outset a cash flow forecast and listing all relevant assumptions made. The assumptions should be carefully prescribed and include economic, commercial and technical assumptions with a range of predicted outcomes. This may be used as a safe harbor to prove what was reasonably foreseeable at the outset.

  - Not every taxpayer is a prophet. But the safe harbor would mean no subsequent hindsight taxation unless fraud can be proven (a criminal matter). Otherwise, both the taxpayer and the tax authority would be bound by the safe harbor.

  - The safe harbor may also include a sliding scale – this would further show good faith but should not be mandatory.

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We will be happy to answer any questions arising.

Yours Truly

Leon Harris, CPA (Israel), FCA(UK)
18 June 2015

VIA E-MAIL

Mr. Andrew Hickman
Head of Transfer Pricing Unit
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TransferPricing@oecd.org

Re: Comments on the 4 June 2015 Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles

Dear Mr. Hickman:

The International Alliance for Principled Taxation (IAPT or Alliance) is a group of major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, telecommunications, oilfield services, transportation, computer technology, energy, pharmaceuticals, beverages, software, IT systems, publishing, and electronics. The group’s purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The Alliance appreciates the opportunity to provide input to the OECD with respect to the Discussion Draft on hard-to-value intangibles released by the OECD on 4 June 2015 in the context of BEPS Action 8. Our comments are set forth in the Annex to this letter.

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1 The current membership of the IAPT is made up of the following companies: Adobe Systems, Inc.; Anheuser-Busch InBev NV/SA; A.P. Møller-Mærsk A/S; AstraZeneca plc; Baker Hughes, Inc.; Chevron Corporation; Cisco Systems, Inc.; The Coca-Cola Company; Exxon Mobil Corporation; Hewlett-Packard Company; Johnson Controls, Inc.; Juniper Networks, Inc.; Microsoft Corporation; Procter & Gamble Co.; RELX Group plc; Repsol S.A.; TE Connectivity, Ltd.; Thomson Reuters Corporation; Transocean Ltd.; Tupperware Brands Corporation; and Vodafone Group plc.
We look forward to the opportunity to participate in the consultation to be held on 6-7 July 2015 with respect to this topic and would appreciate an opportunity to speak at the consultation. We also stand ready to respond to any questions or to provide further input as the work of the OECD on this item continues.

Sincerely yours on behalf of the Alliance,

Caroline Silberztein
Baker & McKenzie SCP
Counsel to the Alliance

Annex
ANNEX

INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

COMMENTS ON THE 4 JUNE 2015 DISCUSSION DRAFT ON HARD-TO-VALUE INTANGIBLES

18 JUNE 2015
IAPT comments on the 4 June 2015 OECD Discussion Draft:
BEPS Action 8:
Hard-to-Value Intangibles

1 Introduction

1. We are pleased to provide our comments on the OECD Discussion Draft: BEPS Action 8: Hard-to-Value Intangibles (hereafter “the Draft”).

2. We acknowledge the issues posed by hard-to-value intangibles and understand the need for tax administrations to ensure that valuations of significant intangible transfers are supported by solid documentation in relation to the assumptions and projections used. We consider that an approach based on (i) a strengthened documentation requirement commensurate with the significance of the amounts at stake and (ii) a rebuttable presumption for the taxpayer to be able to demonstrate the consistency of the valuation with the arm’s length principle is appropriate to deal with the information asymmetry issue. We support the overall objective pursued with this Draft and command the OECD for its effort to articulate the problem and in particular to differentiate between such an approach and the inappropriate use of hindsight (with the guidance at paragraph 3.74 of the Transfer Pricing Guidelines (TPG) remaining the norm in this respect).

3. We nevertheless find that the proposed draft has the potential to create very significant uncertainty because in our view it is not explicitly grounded in the arm’s length principle, has an overly broad scope, does not provide sufficient clarity as to how to interpret it, and does not provide clarity as to the consequences of characterizing an intangible as HTVI. We listened to public comments from the OECD Secretariat and US Treasury and were comforted that the intention of the drafters is for this new guidance to apply only in cases where the taxpayer cannot demonstrate that it has made a reasonable effort to account for foreseeable events at the time of the valuation. While we expect that the United States in particular will interpret and apply the new guidance in the light of its experience with the existing “commensurate with income” (CWI) rule, we note that most countries do not have such a rule in place in their domestic legislation and do not have experience with the administration of such a rule. Therefore we believe that it is critical for the OECD guidance to be drafted in a more robust, clearer and less subjective manner in order to avoid massive challenges by tax auditors in all jurisdictions of intangible valuations in cases that are not intended to be in the scope of the new guidance.

4. In the following sections, we provide further details about our concerns and suggestions for improvement.

2 Consistency with the arm’s length principle

5. We believe that a clear statement of principle is missing that would clarify that the objective of the proposed approach is to allow tax administrations to ensure that transfers of HTVI are priced in accordance with the arm’s length principle, despite the difficulties inherent in the valuation of HTVI.

6. In addition, while the first part of the Draft (paragraphs 1 to 8) includes some valuable comments about arm’s length arrangements, these are not reflected in Section D.3.1. We suggest that

a stronger connection between the proposed approach in Section D.3.1 and the discussion in the first part of the document should be established in order to more solidly ground the proposed approach in the arm’s length principle. Otherwise, the first part can be read as solely describing difficulties encountered by tax administrations with HTVI without providing any requirement for such difficulties to be resolved within the arm’s length principle, and Section D.3.1 could be read as a standalone section providing guidance which is not grounded in the arm’s length principle and in what independent parties would have agreed in comparable circumstances.

7. We therefore suggest the following addition:

9. This section takes into account the matters set out in the first part of section D.3 and outlines approaches which tax administrations may adopt in dealing with a specific category of intangibles, referred to as HTVI. The proposed approach relies on strengthened documentation requirements for HTVI and the possibility for tax administrations to adjust the conditions of a transfer of HTVI to align them with what would have been agreed between independent parties. In particular, the discussion in the first part of section D.3 of solutions which may be implemented between independent parties at arm’s length provides the basis for the application of the proposed approach to be consistent with the arm’s length principle.

3 Clarify the scope

3.1 Definition of “hard-to-value intangibles”

8. The proposed definition of HTVI at paragraph 9 of the Draft relies on two criteria: lack of sufficiently reliable comparables and significant uncertainties in projections or assumptions used. We think that these two criteria are both relevant, noting that the second one is relevant in the case where a Discounted Cash Flow approach is used, which may not be the only alternative option in the absence of a comparable uncontrolled price (CUP), even though it is broadly used in practice. We are however concerned that the current definition of HTVI can be read as potentially encompassing any intangible for which there is no perfect comparable.

9. With respect to comparables, we note that taxpayers should be able to demonstrate compliance with the arm’s length principle using not only comparables that were available at the time of the transfer, but also information on comparable transactions that are contemporaneous to the controlled transfer, including when such information was not available at the time of the transaction (arm’s length outcome testing). This would be consistent with the existing guidance in TPG 3.68-3.71.

10. Concerning the reliability of projections or assumptions, recognizing that uncertainty always exists in intangible valuation, the OECD should in our view set a clear and objective threshold as to when uncertainty will be regarded as so “high” that a specific administrative approach is needed.

11. Finally, we believe that the list at paragraph 10 should not be illustrative only but should be included in the definition of HTVI (although we do not share the view in the Draft on the inclusion of “Intangibles that separately are not HTVI but which are connected with the development or enhancement of other intangibles which fall within the category of HTVI”).
12. We therefore suggest amending paragraphs 9-10 as follows:

9. The term HTVI covers intangibles or rights in intangibles for which, at the time of their transfer in a transaction between associated enterprises, (i) no sufficiently reasonably reliable comparables exist, and (ii) there is a lack of reliable at the time of their transfer in a transaction between associated enterprises, the projections of future cash flows or income expected to be derived from the transferred intangible (in the case where a Discounted Cash Flow approach was used), or the assumptions used in valuing the intangible are highly uncertain. As a consequence, ex post information provides presumptive evidence as to the reliability of the information used ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles, due to one of the following factors:

10. Intangibles falling within the category of HTVI may exhibit one or more of the following features:

- **The intangible is** Intangibles that are only partially developed at the time of the transfer;

- **The intangible is** Intangibles that are not anticipated to be exploited commercially until several years following the transaction;

- Intangibles that separately are not HTVI but which are connected with the development or enhancement of other intangibles which fall within the category of HTVI;

- **The intangible is** Intangibles that are anticipated to be exploited in a manner that is novel at the time of the transfer.

3.2 **Exceptions - safe harbour**

13. We welcome the caution at paragraph 13 of the Draft that the approach should apply only in situations where the difference between ex post outcomes and ex ante projections is significant. In effect we think that a safe harbour or de minimis rule is needed given the inherent uncertainties in intangible valuation.

14. We however note that this useful statement is not reflected in the proposed guidance at paragraph 14, which is the paragraph providing the exceptions to the proposed approach. We believe that it should be added in paragraph 14 in order for it not to remain a mere declaration of intention.

15. In addition, we find that the use of the word “significant” makes the standard extremely subjective, which defeats the purpose of providing a safe harbour. Intangible valuations are often obtained through the determination of a range, for instance based on more than one scenario, or the use of more than one method. We suggest that the guidance on HTVI should acknowledge the notion of range and/or provide for a numerical safe harbour. It could for instance indicate that a variation of +/- 20% will not lead to the characterization of an intangible as HTVI.
3.3 Use of discount rates -- foreseeable events are reflected with a probability of occurrence

16. Discount rates are used to account for risk. Sensitivity analyses and/or scenario analyses can be undertaken by valuators in the case where the projections or assumptions are highly uncertain. In a valuation based on a Discounted Cash Flow approach, valuators may deal with uncertainty regarding a potentially wide range of future cash flow possibilities by projecting different possible future scenarios (e.g., a “best case”, a “worst case” and/or a “most likely case”). In valuing an individual scenario, the discount rate chosen should reflect the risk of achieving the projected cash flows in that scenario. The probability of the occurrence of each scenario must also be estimated. The overall value estimate is then a probability-weighted average of the company’s estimated scenario values. Alternatively, the expected future cash flows based on the scenarios could be discounted using a conventional, single discount rate to obtain an overall value estimate.

17. Thus, foreseeable events are taken into account in a valuation with an estimate of the probability of them occurring. If an event occurs, which was taken into account in a valuation with a probability of occurrence of say 10%, it is possible that the actual financial outcome will significantly differ from the ex ante valuation, not because the foreseeable event was overlooked, but because the likelihood of the foreseeable event was regarded as low. Similarly, a foreseeable event may have been reflected with say a 50% probability of occurrence and not occur in reality, which could lead a valuation based on actual outcomes to significantly differ from one based on projections. If the probability assessment in the original valuation was consistent with the information available and an appropriate discount rate was used at the time of the controlled transaction, there should be no adjustment to the valuation to reflect the actual occurrence of said event under the arm’s length principle.

18. We are concerned that this fundamental valuation principle is insufficiently reflected in the current Draft, which can be read as suggesting that foreseeable developments or events are either ignored or reflected with a 100% probability of occurrence. The use of appropriate discount rates and probability should be reflected both:

- in the guidance related to the possibility for a taxpayer to demonstrate compliance of the original valuation with the arm’s length principle, and
- in the guidance on the quantum of the adjustment to be made by a tax administration in case of non-compliance.

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3 “Sensitivity analysis involves changing one assumption at a time to see the effect on the estimate of intrinsic value. For example, analysts might examine the impact of a different revenue growth rate on the company’s valuation. Scenario analysis has the same goal, but involves changing multiple assumptions at the same time. For example, analysts might simultaneously change assumptions for revenue growth, operating margin, and capital investment. Either sensitivity analysis or scenario analysis can be used to determine a range of potential intrinsic value estimates based on a variety of different assumptions about the future. Analysts can use either tool to estimate the effect on a company’s valuation of different assumptions for economic growth, for inflation, for the success of a particular product, and so on.” (Source: CFA Program Curriculum – 2015 – Level 2 – Equity).

4 Ibid.
3.4 Assessing outcomes over a sufficient period of time

19. Financial outcomes derived from the exploitation of an intangible may be greater than anticipated in some years and lower than anticipated in some other years. It is therefore important to ensure that tax administrations will not look at one year only, but will consider the period of time which is relevant for the valuation of the intangible in question.

3.5 Drafting suggestions

20. Based on our comments in Sections 3.2 to 3.4, we suggest the following amendments to paragraph 14:

14. The approach described in this section will apply to the transfer of HTVI as defined in paragraph 9, but will not apply where

(A) the valuation based on the actual outcomes is between 80% and 120% of the valuation used by the taxpayer, or

(B) the taxpayer:

1. provides full details of its *ex ante* projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks; and

2. provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to

   • unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction, and/or

   • foreseeable developments or events which were anticipated and taken into account through a discount rate or with a probability rate that appropriately reflected reasonable expectations of occurrence at the time of the transfer. In effect, the occurrence of an event which was foreseen but regarded as having a low probability of occurrence may significantly affect the valuation while not being indicative of non-arm’s length pricing at the time of the transfer.

Because financial outcomes derived from the exploitation of an intangible may be greater than anticipated in some years and lower than anticipated in some other years, a year-by-year application of the approach will generally not be appropriate.

4 Clarify the consequences

4.1 Pointer or rebuttable presumption?

21. We understand that the trigger for the proposed approach is the characterization of a transferred intangible as an HTVI per the definition of paragraph 9. In the presence of an HTVI, the Draft is unclear about whether *ex post* information would be regarded as a pointer (risk assessment) or create a rebuttable presumption or a non-rebuttable presumption. For instance, the Draft contains the following statements:
At paragraph 7: “In these situations ex post profit levels can provide a pointer [emphasis added] to tax administrations about the arm’s length nature of the ex ante pricing arrangement agreed upon by the associated enterprises, and the existence of uncertainties at the time of the transaction. If the difference between the anticipated profit levels and the ex post profit levels is not due to unforeseeable developments or events, the difference gives an indication [emphasis added] that the pricing arrangement agreed upon by the associated enterprises at the time of the transaction may not have adequately taken into account the relevant developments or events that might have been expected to affect the value of the intangible and the pricing arrangements adopted.”

At paragraph 9: “[…] ex post information provides presumptive evidence [emphasis added] as to the reliability of the information used ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles.”

At paragraph 12: “In these circumstances, the tax administration may consider ex post evidence about the actual financial outcomes of the transfer to be necessary in determining the appropriateness of the ex ante pricing arrangements [emphasis added] […]. However, the consideration of ex post evidence should be based on a determination that such evidence is necessary to be taken into account when and in so far as there is no other information to assess the reliability of the information on which ex ante pricing has been based [emphasis added].”

At paragraph 15: “As a result, although the ex post evidence about financial outcomes provides relevant information [emphasis added] for tax administrations to consider the appropriateness of the ex ante pricing arrangements, in circumstances where the taxpayer can satisfactorily demonstrate [emphasis added] what was foreseeable at the time of the transaction and reflected in the pricing, and that the developments leading to the difference between projections and outcomes arose from unforeseeable events, no adjustment to the ex ante pricing arrangements based on these special considerations would be justified [emphasis added].”

22. We suggest that the Draft should be made clearer as to whether the proposal is to set a pointer (as proposed in paragraph 7) or a rebuttable presumption (as proposed in paragraphs 12 and 15). The reference to “presumptive evidence” at paragraph 9 should in our view be deleted as it should be made perfectly clear that the intention is not to set a standard whereby prices for the transfer of intangibles would systematically be adjusted based on actual outcomes.

23. Finally, the OECD should clarify that:

- A tax administration willing to adjust the price of a transaction based on the proposed evidence should provide a detailed explanation of why it believes that the valuation used by the taxpayer at the time of the transfer was not arm’s length. The mere existence of a difference between the financial projections and the actual outcomes should not suffice to justify an adjustment.

- The taxpayer should have the possibility to rebut the presumption by providing evidence of the reasonableness of the projections and assumptions used at the time of the transfer.

- Contrary to what is suggested at paragraph 12, it is not for the tax administration to be able to confirm the consistency with the arm’s length principle of the ex ante pricing, as judges and Competent Authorities should independently examine the information submitted by the taxpayers.
- Also, a taxpayer should not be required to demonstrate “the reliability of information on which ex ante pricing has been based”, because the whole issue with HTVI is that reliability of ex ante pricing is affected by uncertainties. We believe that the taxpayer should instead be required to demonstrate that foreseeable developments or events were appropriately taken into account, based on information that was available at the time of the transfer.

24. We therefore suggest the following edits:

9. […] ex post information provides presumptive evidence as to can be relevant for a tax administration to assess whether, in determining the ex ante pricing, the taxpayer reasonably took into account developments or events that were foreseeable at the time of the transactions ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles. […]

12. In these circumstances, the tax administration may consider ex post evidence about the actual financial outcomes of the transfer to be necessary in determining the appropriateness of the ex ante pricing arrangements, and may adopt the approach set out in this section, D.3.1. However, the consideration of ex post evidence should be based on a determination that such evidence is necessary to be taken into account when and in so far as there is no other information to assess the reliability of the information on which ex ante pricing has been based. In addition, a tax administration willing to adjust the price of a transaction based on ex post evidence should provide a detailed explanation of why it believes that the valuation used by the taxpayer at the time of the transfer was not arm’s length. The mere existence of a difference between the financial projections and the actual outcomes should not suffice to justify an adjustment. Where the tax administration taxpayer is able to confirm the reliability of that the information on which ex ante pricing has been based reasonably took into account foreseeable developments or events at the time of the transactions, notwithstanding the special considerations described in this section, then adjustments based on ex post profit levels should not be made.

4.2 Determining the quantum of the adjustment

25. The Draft does not provide any clear guidance as to how the adjustment should be determined, in the case where it is established that a taxpayer did not appropriately reflect foreseeable developments or events in the valuation.

4.2.1 No systematic adjustment based on actual performance: take into account developments and events that were foreseeable with a reasonable estimate of their likelihood of occurrence based on information available at the time of the transaction

26. In our view, the adjustment should be determined by re-calculating the value at the time of the transfer and appropriately reflecting foreseeable developments or events based on information that was available at that time (including on the likelihood of particular developments or events to effectively occur as noted in Section 3.3 above). This would be consistent with the proposed guidance at paragraph 7 of the Draft.

27. This should be made explicit in Section D.3.1. Otherwise, some tax administrations may read Section D.3.1 as opening the possibility to make adjustments based on actual outcomes without due consideration of information that was foreseeable at the time of the transaction. We are very concerned that the current draft Section D.3.1 is unclear in this regard and open to diverging interpretations.
4.2.2 Allocation of outcomes attributable to synergies

28. In our view the Draft omits the fundamental question of how to share anticipated synergy gains between the transferor and the transferee.

29. Illustration: Assume for instance that entity A is the owner of an intangible which has some narrow applications, and that the highest value of that intangible for A, given its other options realistically available (e.g., direct exploitation of the intangible, sale to a third party or licensing out to a third party), is 100. Assume that company B is able to integrate the intangible with other intangibles it owns or on which it has rights and/or to commercialize the intangible to a broader client base. B may be able to derive a value of 150 from the intangible. A would not be able to derive such value without access to B’s other intangibles and client base.

30. In such an example, the Draft seems to suggest that the tax administration of company A could claim an upward adjustment of the value of the intangible transfer to 150, notwithstanding the fact that the incremental value of 50 is solely attributable to synergies with B’s own assets. At arm’s length, we believe that A would at best be able to obtain a premium over the standalone valuation of 100, but not 150.

31. We understand that the Draft’s position in this respect may be underpinned by the concept of valuation based on the “highest and best use” of the intangible. We however respectfully submit that the concept of highest and best use should not mean that the transferor will be able to capture the entirety of the synergies created by the transferee.\(^5\)

4.2.3 Allocation of outcomes attributable to more successful (or poorer) performance by the transferee

32. The Draft also omits the question of who, transferor or transferee, should be allocated the upsides or downsides arising from the greater or poorer performance of the transferee compared to expectations.

33. Illustration - downside scenario: Assume now that company X transfers an intangible to company Y and that based on reasonable projections and assumptions at the time of the transfer, the value is set at 100. However, in the years following the transfer, Y is less efficient than expected, and is only able to derive a value of 75 from the intangible. This example assumes that the company Y has the human and material capabilities to reasonably be able to achieve the projections, but fails to do so, i.e., such underperformance is solely due to a lack of efficiency of Y, not to its lacking the resources needed to achieve the projections and also not to any extraordinary event such as a major market collapse or emergence of a new competitor.

\(^5\) Fair value is the definition of value used in financial reporting. The definition of fair value includes references to an arm’s-length transaction (i.e., neither party is acting under duress) as well as the parties to a transaction being knowledgeable. Under IFRS (and US GAAP), fair value is defined as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between marketplace participants at the measurement date”. Note that this definition involves an exit price, the price that would be received to sell an asset (or be paid to transfer a liability). An exit price should be less than or at most equal to the price paid to establish a position (an entry price). The concept of value to a specific buyer taking account of potential synergies and based on the investor’s requirements and expectations is called investment value. (Source: Ibid).
34. The Draft seems to suggest that the tax administration of company Y could claim a downward adjustment of the value of the intangible transfer to 75, notwithstanding the fact that the loss in value of 25 is solely attributable to Y’s own underperformance.

4.2.4 Drafting suggestions

35. Based on the above, we suggest that the OECD provide that in determining any transfer pricing adjustment of the intangible value,

- Restated projections should be used based on (i) the transferor’s best available option at the time of the transfer and (ii) discount rates and probability factors which reflect reasonable anticipations of foreseeable events at the time of the transfer.

- Greater efficiency or inefficiency of the transferee can be one example of an unforeseeable factor that could not be anticipated at the time of the transfer and could justify a positive or negative difference between the projections and the actual financial outcomes, without being indicative of non-arm’s length pricing.

4.3 Determining the structure of the adjustment

36. The OECD acknowledges at paragraphs 2-4 of the Draft that at arm’s length, a variety of solutions could be adopted by unrelated parties to deal with uncertainties. This may include, depending on the facts and circumstances,

- The use of anticipated benefits (taking into account all relevant economic factors) as a means for establishing the pricing at the outset of the transaction;

- The adoption of shorter-term agreements,

- The inclusion of price adjustment clauses in the terms of the agreement,

- The adoption of a payment structure involving periodic milestone payments to protect against subsequent developments that might not be sufficiently predictable,

- Bearing the risk of unpredictable subsequent developments,

- In case of major unforeseen developments changing the fundamental assumptions upon which the pricing was determined, renegotiating the pricing arrangements by agreement of the parties where it is to their mutual benefit.

37. While the OECD rightly points that all these scenarios may happen at arm’s length, it does not provide any clear guidance as to:

- what scenario would occur in what circumstances,

- the determination of the financial effect of any of these proposed scenarios: e.g., would a contingent payment represent 1%, 5%, 10%, 50% of the lump sum payment?

- what milestones would be appropriate to consider and in what circumstances.

38. In our view, providing such guidance on the circumstances in which each of the listed scenarios would be put in place and its quantification and timing would be an impossible undertaking. This is because the range of arm’s length contractual arrangements and risk allocations between third parties is infinite.
39. As a consequence, we believe that the OECD should not leave it open for tax administrations to determine which of the listed scenarios they prefer and quantify notional contingent payment versus lump sum payments. A lump sum payment can be consistent with the arm’s length principle if it appropriately captures foreseeable developments. Alternatively, contingent payments may be put in place at arm’s length for a variety of reasons.

40. Given that independent parties may adopt a variety of solutions to deal with comparable circumstances and that accordingly it is not possible for the OECD to dictate precisely what pricing structure would have been adopted in what circumstances, the OECD should in our view provide guidance for tax administrations to ensure that the overall payment made for a transferred intangible is arm’s length (i.e., appropriately reflects foreseeable developments and events as well as the probability of their occurring). On the other hand, lacking any clear guidance on what structure and timing would be most appropriate in a given case, the OECD should not provide guidance that opens up the possibility for tax administrations to arbitrarily recharacterise the structure and timing of payments.

41. Doing otherwise would create massive uncertainty as each tax administration could take a differing approach, leading to increased risk of double taxation. Alternatively, tax administrations who believe that the nature and timing of payments should be recharacterised should only do so in agreement with the competent authority of the other jurisdiction concerned by the transaction.

4.4 Cases where the pricing would be renegotiated

42. In those cases where “major unforeseen developments changing the fundamental assumptions upon which the pricing was determined” would lead the tax administrations to consider that the terms of the agreement should be renegotiated, tax administrations should bear in mind that at arm’s length this would only happen on a prospective (rather than retroactive) basis, and only where the renegotiation by agreement of the parties is to their mutual benefit, as acknowledged at paragraph 4.

43. This important aspect should be made explicit in Section D.3.1 of the Draft.

5 Implementation

44. The proposed guidance creates a new documentation requirement, which companies may not be in a position to fulfil for intangible transfers that took place prior to its adoption. Accordingly, we think that the new guidance should only apply to transfers that will take place after the final new guidance is incorporated into the OECD TPG.

6 Elimination of double taxation

45. Given the potentially far-reaching and monetarily significant consequences of the proposal, the OECD should incorporate guidance to ensure that double taxation which may result from adjustments made under this approach will be capable of elimination. This includes ensuring that countries will provide corresponding adjustments irrespective of domestic time limits (see TPG 4.43 - 4.51).

46. More generally, we believe that the risk of disputes and double taxation will be better minimized if clearer and more robust guidance is provided on the scope of the new approach and the consequences of applying it, including the determination of the resulting adjustment (see above).
7 Other drafting suggestions

47. At paragraph 5, the words “If independent enterprises would have insisted on a price adjustment clause” should be replaced with “If independent enterprises would have agreed on a price adjustment clause”.

48. At paragraph 6, replace “These situations can give rise to a risk of systematic mispricing.” with “These situations can give rise to a risk of mispricing.” in order to keep the tone of the OECD TPG neutral.

49. At paragraph 9, replace “This section […] outlines approaches” with “This section […] outlines an approaches”.

50. At paragraph 13, we think the words “such a difference is due to developments or events that were or should have been foreseeable at the time of the transaction” should be replaced with “such a difference is due to developments or events that were or should have been foreseeable at the time of the transaction”. Alternatively, these words could be replaced with “such a difference is due to developments or events that were foreseeable or should have been foreseeable at the time of the transaction”, although we think that “should have been foreseeable” is less meaningful than “foreseeable”.

51. Consistency changes should be made to paragraph 3.73 of the TPG. We suggest the following:

3.73 The reasoning that is found at paragraphs 6.28-6.32 and in Annex to Chapter VI “Examples to Illustrate the Transfer Pricing Guidelines on intangible property and highly uncertain valuation in Chapter VI, Section D.3 for transactions involving intangibles for which valuation is highly uncertain at the time of the transaction” applies by analogy to other types of transactions with valuation uncertainties. The main question is to determine whether the valuation was sufficiently uncertain at the outset that the parties at arm’s length would have required a price adjustment mechanism, or whether the change in value was so fundamental a development that it would have led to a renegotiation of the transaction. Where this is the case, the tax administration would be justified in determining the arm’s length price for the transaction on the basis of the adjustment clause or renegotiation that would be provided at arm’s length in a comparable uncontrolled transaction. In other circumstances, where there is no reason to consider that the valuation was sufficiently uncertain at the outset that the parties would have required a price adjustment clause or would have renegotiated the terms of the agreement, there is no reason for tax administrations to make such an adjustment as it would represent an inappropriate use of hindsight. The mere existence of uncertainty should not require an ex post adjustment without a consideration of what independent enterprises would have done or agreed between them.

52. Finally, it is unclear to us whether the examples that are in the Annex to Chapter VI of the TPG will remain or be deleted.
Comments to the OECD Discussion Draft on BEPS Action 8 “Hard to value intangibles”

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, welcomes the opportunity to provide comments on the Discussion Draft on BEPS Actions 8 which sets out proposals to modify chapter VI of the OECD Transfer Pricing Guidelines (the “Guidelines”) in relation to “hard to value intangibles” and proposes revisions to the guidance in Section D.3 of the 2014 BEPS Report “Guidance on Transfer Pricing Aspects of Intangibles”.

ICC agrees with two principles which are stated, respectively, in paragraph 1 and paragraph 4 of the discussion draft:

(1) “When valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, the question arises as to how arm’s length pricing should be determined. The question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in the pricing of the transaction.”

(4) “Also, independent enterprises may determine to bear the risk of unpredictable subsequent developments”.

The principle stated in paragraph 1 seems to be limited in its applicability by the introduction of special measures to protect tax administrations against the negative effects of information asymmetries (as well as lack of specialised knowledge, expertise and insight into the business environment in which the intangible is developed or exploited).

While understanding concerns regarding information asymmetry, ICC observes that this will probably be mitigated by the new rules on transfer pricing documentation. In this regard, in order to preserve consistency with the arm’s length principle, ICC believes that the special measures should not go beyond refutable presumptions, in the sense that the taxpayers should be allowed to use any possible information to support the arm’s length nature of the transactions, even if such information becomes available after the time of setting the prices.

ICC also observes that special measures should not be applied retroactively and urges the OECD to make a clear statement on this.

The principle stated in paragraph 4 seems to be disregarded in the following sections of the discussion draft, which focus on:

- whether or not ex-ante projections were accurate and comprehensive enough in considering reasonably foreseeable events and other risks; and
- whether or not any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated at the time of the transaction.
ICC recommends the completion of the guidance with a description of conditions under which an ex-ante decision of excluding any renegotiation of the pricing should be respected and consistent with arm’s length dealings.

ICC also observes that reference to “whether the guidance on non-recognition applies”, at the very beginning of paragraph 1 gives the impression of emphasizing non-recognition instead of considering it an exceptional circumstance.

ICC would like to highlight that the draft guidance puts a significant burden on taxpayers - requiring detailed, accurate and comprehensive ex-ante documentation. This raises particular concerns in relation to developing countries. First of all in relation to the burden on taxpayers, but also on tax administrations which will have the responsibility to review and assess such documentation. Moreover, similar concerns will most notably apply to small and medium enterprises (SMEs). ICC therefore recommends that the OECD explicitly mentions in its guidance the fact that a number of hard-to-value intangibles can be more easily priced using one-sided methods when comparables can be used to set the remuneration of the simplest party in the transaction.

The approach to transfer of hard to value intangibles (HTVI) is said (in par. 14) to not apply where the taxpayer:

1. provides full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks; and
2. provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.

ICC believes that the second element should be subject to a condition of “or” instead of “and” as unforeseeable and extraordinary events may occur also in case of intangibles that are not HTVI by nature.

In the case of transfer of rights, ICC recommends acknowledging that the parties will first monitor results that are significantly different from what was anticipated in order to assess whether the change is permanent or temporary: this may take quite a long time. In addition, independent parties are more likely to modify pricing prospectively rather than retroactively.

Finally, ICC observes that ex-post adjustments initiated by a tax authority are likely to raise double taxation concerns in the absence of mechanisms that would ensure corresponding adjustments on the other side. ICC therefore strongly encourages the OECD to take actions in the direction of developing a global consensus on how to facilitate offsetting adjustments.
The International Chamber of Commerce (ICC) Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy. Founded in 1919, and with interests spanning every sector of private enterprise, ICC’s global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.
Mexico City, June 18, 2015

Via e-mail
TransferPricing@oecd.org
OECD
Mr. Andrew Hickman
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration

Dear Mr. Hickman,

On behalf of IFA Grupo Mexicano, A.C. (Mexican Branch of the International Fiscal Association) kindly find below our comments on the Public Discussion Draft on BEPS Action 8 – “Hard-to-value Intangibles”.

BEPS Action 8: Hard-to-Value Intangibles

I. Overview

The Discussion Draft focuses on the OECD’s intention to develop transfer pricing rules or special measures for transfer hard-to-value intangibles. The draft is a discussion to develop an approach to hard-to-value intangibles and proposes revisions to the existing guidance in Section D.3 of Chapter VI of the Transfer Pricing Guidelines.
II. Comments

A. Need for clear guidelines to what independent enterprises would have done in comparable circumstances

The Discussion Draft takes an approach regarding the steps that independent parties might undertake to deal with high uncertainty in valuation when pricing a transaction.

First of all, we believe that in general, independent parties are not usually involved in the acquisition of intangible property on an isolated basis, but regularly independent parties are willing to acquire a business as a whole, which might include important intangible property as part of the acquisition. Moreover, it is quite uncommon to have access to details about those deals, so the taxpayers may face difficulties in obtaining information publicly available regarding this kind of transactions for comparability purposes.

The Discussion Draft establishes that one possibility is for the taxpayer to use anticipated benefits in the valuation, taking into account the extent to which subsequent developments are foreseeable or predictable.

However in general terms, a key assumption for performing a reliable valuation in methodologies where anticipated benefits are considered (no matter what kind of intangible asset is being valued) is that the projection of benefits is prepared according to the most reliable information available at the moment of the transaction and considering reasonable future effects based on recognized publications or institutions (e.g. expected inflation or economic growth), so we think the discussion draft would benefit from a more detailed description than the common terms mentioned.

The second possibility established in the Discussion Draft is that independent enterprises might adopt shorter-term agreements, including price adjustment clauses in the terms of the agreement, or adopt a payment structure involving periodic milestone payments to protect against subsequent developments that might not be sufficiently predictable.

Since taxpayers would face difficulties in having access to information of third party transactions that involve intangible assets, or since it may be the case that such kind of information is not available at all so as to be used as comparable information, it might be useful for taxpayers and tax authorities that the OECD draft provide more examples or guidelines to be considered when intangible assets are involved and under what circumstances.
B. Ex post profit levels can provide a pointer to tax administrations about the arm’s length nature of the ex ante pricing arrangement

The Discussion Draft sets out that if the difference between the anticipated profit levels and the ex post profit levels is not due to unforeseeable developments or events, the difference gives an indication that the pricing arrangement agreed upon by the associated enterprises at the time of the transaction may not have adequately taken into account the relevant developments or events that might have been expected to affect the value of the intangible and the pricing arrangements adopted.

As previously pointed, in valuation methodologies in which anticipated benefits are considered, the projection of benefits is calculated using the best available information at the moment of the transaction and considering all of the foreseeable and predictable effects that would add value in the future to the intangible asset under valuation.

In this regard, we consider that the draft should be mainly focused on reviewing the ex ante pricing arrangement established between independent parties, and to verify that at the moment of valuation the assumptions considered by the related parties were in accordance with all the relevant circumstances, considering the foreseeable and predictable effects. Otherwise (although the draft clearly states it is not desirable) we will be facing very often hindsight situations when dealing with unanticipated results.

In this regard, taxpayers should maintain full details of their ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of the consideration of reasonably foreseeable events and other risks.

Additionally, taxpayers should also provide satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.

For ex post reviews and controversies it is highly recommended that the OECD provide detailed guidelines related to the scope of the analysis, minimum thresholds, guidelines for transfer pricing adjustments, among others, that should have significant effects for both taxpayers and tax authorities.
The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA Branch, and in no case in the name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano, A.C.
Dear Mr. Hickman

Submission in response to OECD Discussion Draft on Action 8: Hard-To-Value Intangibles

Please find enclosed our submission in response to the Discussion Draft on Action 8: Hard-To-Value Intangibles that was released on 4 June 2015.

The Irish Tax Institute and our members acknowledge the importance of the OECD and tax authorities to implement measures that can prevent or mitigate the impact of abusive tax planning or abusive transactions of certain taxpayers. On behalf of our members, we submit comments in response to the efforts by the OECD to address a challenging technical topic within transfer pricing.

We would like to thank Warren Novis, Jessica Xu and the Transfer Pricing team from KPMG Ireland for their assistance in preparing our submission and gathering input from members in the Irish Tax Institute.

We welcome the insights to be gained from the final Public Consultation and trust that our comments on this Discussion Draft contribute to the debate.

We are available for further discussion on any of the matters raised in our submission.

Yours truly,

Andrew Gallagher
President
Irish Tax Institute
Irish Tax Institute

Response to OECD Discussion Draft:
Hard-To-Value Intangibles

June 2015
About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland’s AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

Our response

The Irish Tax Institute is writing in response to the Discussion Draft on the Hard-To-Value Intangibles, which the OECD released on 4 June 2015. We prepared this submission with consideration and input from our members.

Overview

One of four components of Action 8 of the OECD’s Base Erosion and Profit Shifting (“BEPS”) project was to focus on developing rules to price the transfer of hard-to-value intangibles (“HTVI”). We recognise that the Discussion Draft has made efforts to provide clearer guidance on when tax authorities may apply *ex post* evidence to test a transfer of HTVI. However, our concern is that the rules specified in the Discussion Draft will create undue burden on taxpayers to monitor outcomes of a transaction even when a comprehensive business-focused analysis was conducted to price the intangible.

The Irish Tax Institute recognises the importance for tax authorities of obtaining a fair and accurate depiction of the facts based on reliable projections of the business. In principle, the fixed price terms established by taxpayers within a multinational group should be based on the same circumstances
routinely affecting uncontrolled parties. That is, all parties are assuming risk by agreeing on a price today where the future value is uncertain.

It is critical that BEPS solutions are framed to prevent abusive transactions without disproportionately creating risk for the majority of transactions which are supported by adequate substance and analysis. A lack of balance in the BEPS recommendations will greatly increase tax disputes and cases of double taxation, and result in overburdened tax authorities and taxpayers. We would recommend a pragmatic approach to avoid placing more pressure on an already burdened dispute resolution process and add further uncertainty to ordinary commercial transactions.

We observed the Discussion Draft was not a consensus document. In order for revised guidelines on transfer pricing to be successful for both taxpayers and tax authorities, broad consensus within Working Party 6 must be achieved prior to new guidelines taking effect.

The general issue with taking _ex post_ evidence is that tax authorities may consider to their advantage information which has become known, that was previously unknown to the taxpayer at the time of the transaction. While taxpayers’ facts and assumptions are being put to the test in this section of Chapter VI, a fair and balanced view by the OECD is required. That is, tax authorities should be held to the same standard to demonstrate that _ex post_ evidence was either known or reasonably foreseeable at the time of the transaction.

Finally, it is in this section where the OECD may wish to consider incorporating quantifiable thresholds to provide a degree of certainty for all stakeholders. We welcomed a proposed change to Chapter VII (Low Value-Adding Services), where paragraph 7.57 indicated a specific range of mark-up between $2\%$ and $5\%$ as acceptable. We strongly encourage the OECD to continue providing such useful boundaries, in particular in the HTVI section of Chapter VI.
Comments on the Discussion Draft

Consistency with Chapter I, VI and Risk – The transfer of an HTVI for a price is a fundamental transfer of risk from the seller to the buyer. The transfer price reflects an assessment between the parties of the agreed value of the risk. The current revisions to Chapter I and VI of the OECD Guidelines, as they pertain to risk allocation, are not yet finalised. Those revisions are intended to ensure that risk is properly allocated to where the key functions are performed to control and manage that risk. We suggest the OECD considers the impact of such changes on the HTVI rules in Section D.3 of Chapter VI. The HTVI rules currently do not mention risk and risk allocation. It is important that the OECD establishes consistency between the other revisions, and in particular the Risk and Recharacterisation Discussion Draft and the HTVI rules, so that tax authorities do not allocate risk away from where the risk control and management functions are undertaken.

How to Define an HTVI? – Hard-to-Value Intangibles, by their inherent nature, are difficult to define prescriptively to cover all cases. In this respect, the steps by the OECD to define HTVI in Paragraph 9 would therefore provide substantial leeway for tax authorities to deem many intangible transactions as being within the HTVI rules contained in Section D.3 of Chapter VI. Whilst we appreciate the OECD’s efforts to provide greater certainty around the types of intangible that could potentially trigger the HTVI rules, the definition of HTVI should be confined to specific types of transactions. In the absence of this, HTVI could be opened to interpretation by tax authorities which could result in transactions being treated as HTVI and consequently re-priced under the proposed rules.

Paragraph 10 of the Discussion Draft identifies features of intangibles that may qualify them as HTVI. We would recommend a more restrictive list of attributes, as opposed to the non-exhaustive list of traits used to determine whether the transaction could be characterised as a HTVI. This would reduce uncertainty and disputes arising over which transactions are in fact HTVI and therefore subject to potential re-pricing using ex-post evidence.

Proving Foreseeable vs. Unforeseeable – Paragraph 13 stipulates that tax authorities may only apply ex post evidence when the difference between projections and actual outcomes are “significant”, and when differences are attributed to events that were unforeseen at the time of the transaction. On one hand, we perceive the recognition of unforeseen events as a positive development in the rules (e.g. owing to natural disaster, unexpected bankruptcies, recessions, financial market crashes, etc.), whereby the taxpayer would be deemed to have established an arm’s length price. That said, aside major global
or regional events, it will be a challenge for taxpayers to evidence, without scrutiny, unforeseeable commercial events that caused divergence between financial projections and actual outcomes. We later request for more guidance on this matter.

**Importance of Contemporaneous Documentation and Shifting Burden of Proof** – We are extremely concerned about the undue administrative and financial burden caused by a substantial change from the initial guidance set forth in Special Measures – Option 1, in the December 2014 discussion draft on Risk & Capital. In Option 1 (Hard-to-Value Intangibles), the paper cited that an HTVI measure would target the following circumstances where the taxpayer:

1. Fixes the price either as a lump sum or a fixed royalty rate on the basis of projections without any further contingent payment mechanism; **AND**
2. Does not contemporaneously document those projections and make them available to the tax administration.

The above language in Special Measures states that the taxpayer must fail both tests in order for the tax authority to be able to apply *ex post* results to re-price the transaction. This is a fair test to apply to the pricing of HTVI.

The Discussion Draft, however, does not appear to place much reliance on the taxpayer’s contemporaneous documentation of its *ex ante* projections and assumptions underlying the projections. Rather, the Discussion Draft almost assumes in paragraph 12-13 that differences between the projections and actual results warrant further analysis beyond the contemporaneous documentation, unless the tax authority confirms the reliability of the *ex ante* projections by the taxpayer. This is a much higher standard for the taxpayer to achieve as it is based on the tax authority attaining a comfort level on the transaction.

Paragraph 14 presents two conditions which will exempt a transaction from being re-priced under the proposed HTVI rules. There is an onerous **two-step** requirement for taxpayers to avoid the transaction from being re-priced. Our key concern is the second step, which requires taxpayers to maintain and document “satisfactory evidence” that significant differences between financial projections and actual outcomes were owing to unforeseen events not anticipated at the time of the transaction. There is concern that tax authorities will have a much higher standard of what constitutes “satisfactory evidence”, thus leading to numerous challenges on the transaction itself.
The second obligation **should not** exist in tandem with the obligation to contemporaneously document the original transaction. It would not represent arm’s length standards for taxpayers to routinely track actual outcomes against original projections, as well as to explain or examine the differences. It is our recommendation that where a taxpayer, in its own view, contemporaneously documents the pricing of its transaction as being arm’s length in terms of valuation, terms and conditions, it becomes the tax authority’s burden of proof to demonstrate that the arrangement entered into by the taxpayer is not arm’s length.

Our recommendation is in effect to re-introduce the conditions that were set out in the Special Measures Option 1, which we have summarised in the diagram below in comparison to the current language in the Discussion Draft.

![Diagram comparing Special Measures Draft Option 1 and Action 8 HTVI (June 2015)]
Contingent Payment and Double Tax – A fixed price arrangement provides simplicity in its nature and an element of certainty to the parties involved. The taxpayer can establish a reasonable estimate of an arm’s length price, and tax authorities on both sides of the transaction are able to audit the one-off transaction based on best available forecasts and assumptions.

Paragraph 12 of the Discussion Draft highlights the types of alternative arrangements that could have been entered into to mitigate the uncertainty of a fixed price agreement. Paragraph 12 cites contingent payment arrangements as mechanisms that, if undertaken by arm’s length parties, may need to have been an option considered by the taxpayer. Any preference by the OECD toward contingent payment mechanisms may lead to greater double taxation in two distinct ways.

1 Taxpayers may feel the need to price intangibles through contingency mechanisms. When the contingency realises a price adjustment, one tax authority is likely to deny the adjustment while the other advocates for it. Such an approach would likely place the transaction and the parties involved into formal dispute resolution or measures for reciprocity of treatment.

2 Tax authorities may automatically impute a contingency element to a fixed price transaction, and do so when a contingent price adjustment is in its favour, to the disadvantage of another tax authority. This response to the HTVI rules could have an adverse knock-on effect on other non-HTVI transactions to be treated in the same manner where tax authorities impute contingency adjustments on fixed price contracts.

As stakeholders in the evolving state of international tax reform, we are aware of the challenges the OECD is confronting by the attempt to shape HTVI rules since first covered in the Special Measures draft in December 2014. We believe it is crucial that substantial refinement to this Discussion Draft takes place, especially due to the lack of consensus, that and this should be achieved prior to being finalised in September 2015.
Proposed Suggestions to Discussion Draft

We welcome the proposal by the OECD to include in the Discussion Draft an invitation for comments specific to three topics:

(i) Mechanisms to provide greater certainty to taxpayers
(ii) Additional exemptions to supplement paragraph 14
(iii) Notion of “significant difference” as noted in paragraph 13.

Mechanisms to obtain greater certainty

Timing – Tax authorities should not have unlimited jurisdiction to re-evaluate intercompany transactions, even if the domestic tax statute permits the tax authority an infinite or extended period to conduct an audit. Greater certainty would be achieved if there were a defined period where after no ex-post evidence could be applied by tax authorities and taxpayers would not need to evaluate ex-post evidence. The lifetime of many forms of HTVI, such as patents, may have useful economic lives greater than 10 years, which is an administratively long time to track and compare actual to forecast results.

It might be appropriate for the OECD to consider either: (i) pre-existing rules in the United States transfer pricing regulations which imposes a 5 year limitation from the date of the transaction; or (ii) a period reflecting the useful economic life of the underlying assets as defined by generally accepted accounting principles.

Unforeseeable events – The Discussion Draft allows actual results to differ from projections, so long as those differences develop from unforeseeable events. Paragraph 15 identifies two such unforeseeable events (natural disaster and bankruptcy of a competitor). It would be beneficial for both taxpayers and tax authorities for the OECD to list more general instances that it considers unforeseeable events (e.g. financial market crises, product failures/recalls, etc.). Otherwise, there is concern that tax authorities may disagree with events the taxpayer deems unforeseeable.

Relief from Double Tax – A transfer pricing adjustment made by one tax authority to the transfer of an HTVI will present different double tax relief issues, when compared to a transfer pricing adjustment on the license of an HTVI. The Discussion Draft provides guidance on when the tax authority should (and
should not) be able to apply *ex-ante* financial results to the price of an HTVI. Additional guidance could be included in Section D.3 of Chapter VI to indicate how the tax authorities should be resolving a Mutual Agreement Procedure matter pertaining to HTVI.

**Additional exemption**

A particularly important exemption should apply when taxpayers have demonstrated that the HTVI transaction was structured and priced in such a way that is consistent with similar arrangements undertaken by parties dealing at arm’s length. We would appreciate exampled guidance on what the OECD would constitute arm’s length evidence.

In defining exemptions, it is important to recognise the business purpose of why taxpayers may undertake transfers of HTVI within a group. A key purpose is to centralise ownership, control and decision-making on key intangibles. It is very common that the transfer of an HTVI occurs immediately subsequent to a corporate acquisition, with intangibles residing in the newly acquired company. The purchasing company will ordinarily undertake a commercial valuation of the intangibles prior to making the corporate acquisition for a defined price. The commercial valuation is based on best available projections at the time, and these projections form the basis for the board to authorise funds to make the corporate acquisition.

According to paragraph 12, taxpayers are exempt from HTVI rules “where the tax administration is able to confirm the reliability of the information on which *ex ante* pricing has been based”. We suggest paragraph 12 is elaborated to specifically refer to where the taxpayer demonstrates that the financial projections, the data and assumptions are primarily used for non-tax reasons.

**Defining “Significant Difference”**

Paragraph 13 of the Discussion Draft states that *ex-post* evidence should only be permitted to make adjustments to the price of an HTVI when the difference between *ex ante* projections and *ex post* results is significant.

It is important to note two substantially different types of HTVI scenarios. The first is where the HTVI is valued at a development stage where it is possible zero income may be derived, such as the development being cancelled prior to commercialisation or a product not being approved to be sold to
the market. The second is where the HTVI is valued at a stage where income is almost certainly guaranteed, but where the quantum of that income is hard to predict with good accuracy.

In the first case, the value of the HTVI will be based on the relative likelihood of earning some income and earning zero income, akin to a pass-or-fail situation. If each outcome is likely at the time the HTVI is transferred, then the \textit{ex ante} value will be in between zero and a value reflecting the future income. In these cases, it is guaranteed that the \textit{ex post} result will \textbf{significantly} differ from the \textit{ex ante} value since the actual value from exploiting the HTVI will be zero or an amount greater than the \textit{ex ante} value. This scenario further demonstrates the importance for Chapter VI to not disregard the importance of comprehensive and timely prepared analyses supporting the \textit{ex ante} valuation at the time, covering the information on assumption of risks and foreseeable events.

In the second case, where the value is uncertain but never going to be zero, both taxpayers and tax authorities will benefit from objectivity in defining this term “significant”. Thus, it is advisable the final guidance incorporates easy to apply principles to determine what constitutes a significant difference. What is significant for one taxpayer may not be for another, taking into account their respective industry, capitalisation, geography, etc.

Notwithstanding our concern on the HTVI rules, we would welcome significance expressed as a \textbf{prescribed} percentage of asset value, income of either the seller or purchaser, or other objective measures. In each case, a reasonable range should be considered when developing guidance around this requirement. It may be appropriate to consider pre-existing rules, such as the Cost Sharing Regulations in the United States where the significant difference is defined to be 20\% of the price charged for the intangible asset. In order for a taxpayer to manage its risk, this \textbf{significant} percentage difference must be consistent across its group in all jurisdictions. If one tax authority were to interpret \textbf{significant difference} to be much smaller (e.g. 10\%) than the consensus amongst other tax authorities (e.g. 20\%), by default, all taxpayers would be required to be concerned with the narrowest interpretation (at 10\%) rather than the consensus. Consistent application of HTVI principles is critical to enable management to prioritise transfer pricing analysis and any tracking of the actual results versus forecasts.
Mr. Andrew Hickman  
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Centre for Tax Policy and Administration  
Organisation for Economic Cooperation and Development

Accounting & Tax Committee  
Japan Foreign Trade Council, Inc.

Comments on Discussion Draft on Action 8 (Hard-to-value intangibles) of the BEPS Action Plan

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (“JFTC”) in response to the invitation to public comments by the OECD regarding the “Discussion Draft on Hard-to-value intangibles (“DD”).

JFTC is a trade-industry association with Japanese trading companies and trading organizations as its core members. One of the main activities of the JFTC’s Accounting & Tax Committee is to submit specific policy proposals and requests concerning tax matters. Member companies of the JFTC Accounting & Tax Committee are listed at the end of this document.

General Comments

1. We understand tax administrations may have difficulty in assessing appropriate considerations to be paid for transferred or licensed intangibles due to “information asymmetry”. In case of artificial transactions taking the advantage of this situation, the inappropriate considerations in such transactions should be adjusted to the arm’s length price to ensure the fair competition.

2. However, it would be usual that prices in transactions between independent enterprises are determined based on ex ante information available at the time of the transactions and ex post price adjustments are not made. As transfer pricing taxation relies on conditions of transactions between independent enterprises, special measures should not be taken against hard-to-value
intangibles (“HTVI”), and the appropriateness of ex ante prices should be tested using information available at the time of the transactions. We are seriously concerned that such special measures may result in transfer price adjustments in a mechanical manner regardless of the actual conditions of the business.

3. Even if ex post price adjustments are necessary, tax administrations should bear the burden to prove that such adjustments are consistent with conditions of transactions between independent enterprises.

4. Moreover, it should be noted that even if the tax administration of a relevant country decides to make ex post adjustments, the counterpart tax administration may not have the same view. We have a concern that such cases would lead to increased risks of double taxation. Therefore, ex post adjustments should be made only after relevant countries reach mutual agreement and, if existing Mutual Agreement Procedure (“MAP”) does not work effectively as a relief method, implementation of other relief methods including arbitration should be considered.

**Specific Issues (“Additional points”)**

1. Comments are invited on whether there are mechanisms that could be adopted to provide greater certainty for taxpayers regarding the application of the approach to HTVI.

- Considering the nature of HTVI (i.e., being hard to value), as long as ex ante projections are based on the appropriate assumptions at the time of transactions, the difference between the projections and actual outcomes should be ascribed to unforeseeable developments or events. Though the DD requires taxpayers to prove that the developments or events causing the difference could not have been anticipated, we have a concern that such requirement would increase cases where tax administrations make ex post price adjustments solely due to differences between projections and actual outcomes, which leads to significant uncertainty for taxpayers.

- Therefore, tax administrations should explain sufficiently reasonable grounds to taxpayers before making any ex post price adjustments, and the burden of proof should be placed on the tax administrations.
To enhance certainty, taxpayers may obtain appraisals from independent third party advisors. In practice, appraisals from third parties would be referred to in transactions between independent enterprises, thus taxpayers’ assumptions based on such appraisals should also be well respected for transfer pricing purposes.

Moreover, it should be noted that even if the ex post value of HTVIs are appropriately calculated by taxpayers or tax administrations of a relevant country, tax administrations of the counterpart country may have different views on it. Especially, it is highly likely that double taxation would occur when ex post price adjustments result in reducing the taxable income of a relevant country and the tax administration does not accept such adjustments.

To ensure certainty for taxpayers and eliminate risks of double taxation, ex post price adjustments should be made after relevant countries reach to agreement via MAP.

2. Comments are invited on whether any additional exemptions should be added to the exemption contained in paragraph 14 of this Discussion Draft. Where additional exemptions are proposed, commentators should explain how the exemption should be framed, considering the aims of the approach set out in the Discussion Draft.

Relating to exemptions of ex post adjustments, the following points need to be considered:

- If a certain period of time has passed since a transaction was executed, the transaction would be affected by the changes in economic conditions after the transfer of intangibles. Thus, the exemption should apply to such a transaction as well.
- Burden of proof should be placed on tax administrations to ensure certainty for taxpayers.
- Care should be taken whether ex post price adjustments are actually made in comparable transactions between independent enterprises to prevent taxation which is not based on arm’s length principles.

Taking above three points into consideration, we request revisions of DD as follows (changes to DD appear in underlined for additions and struck through for deletions).
The approach described in this section will apply to the transfer of HTVI as defined in paragraph 9 **within a certain period of time after its execution**, but will not apply where **the taxpayer**:

1. **the taxpayer** provides full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks; and

2. **the tax authority does not** provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.

**or where**

1. **independent enterprises do not actually have a price adjustment clause in comparable transactions; or**

2. **even if independent enterprises actually have a price adjustment, such information could not be obtained from publicly disclosed information.**

3. Comments are invited on whether the notion of “significant difference” in paragraph 13 should be defined, and, if so, what mechanisms could be used to determine whether a difference between the ex ante financial projections and the ex post financial outcomes is significant.

- To ensure certainty for taxpayers and eliminate risks of double taxation, the scope of “significant difference” should be defined in a manner that would not lead to different views among countries.

- In considering “significant difference”, care should be taken not only to extreme cases illustrated in paragraph 15 such as “a natural disaster” or “the unexpected bankruptcy”, but also to uncertainty of the businesses environment such as “the unexpected technical innovation”. In addition, to capture the difference appropriately, the value added by the transferee or the influence of developments after the transfer of HTVIs should be eliminated in measuring the difference. Therefore, it needs to be made sure whether the
difference is ascribed to the transferor of HTVIs or the transferee.

4. Comments are invited on what further matters would be useful to consider in any follow-up guidance on practical and consistent implementation of the approach.

- Though paragraph 10 mentions some features of HTVIs, we request to further clarify the definition using more detailed illustrations to ensure certainty for taxpayers.

- Paragraph 14 requests taxpayers to provide full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements. However, this requirement places a heavy burden on taxpayers, thus documentation requirement regarding ex ante projections needs to be amended so that the scope of documentation may not go beyond a reasonable level.
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Comments on the Public Discussion Draft on BEPS Action 8:  
(Hard-to-Value Intangibles)


Some companies arbitrarily transfer intangibles under development (including rights therein) at an undervalued price to a low-tax jurisdiction and then shift substantial amount of the income derived from the intangibles to a subsidiary domiciled in that jurisdiction. Such a wrongful practice has been pointed out as one of the root causes of base erosion and profit shifting (BEPS). We do understand the need of nations to devise measures against abusive arrangements of this kind.

However, the proposed approach is, albeit some ingenuities shown, essentially an attempt to levy taxes using hindsight, in that it is designed to adjust the ex-ante pricing of transactions based on the ex-post outcomes. As such, a question arises as to its appropriateness as a measure against BEPS. Aware of the difficulty in valuing intangibles and the need to eliminate arbitrariness, companies that conduct controlled transactions involving intangibles endeavor to value the intangibles using methods that are as diverse as possible. Thus, tax administrations should respect the relevant agreements and management decisions, as well as the taxpayer’s valuations underlying them, to the fullest extent. If these could nevertheless be overturned depending on the ex-post outcomes, tax consequences would become unpredictable while the administrative load relating to documentation and the burden of proof would increase.

It is debatable in the first place whether independent enterprises always have a price adjustment clause built into their agreements or renegotiate the agreement terms.
There also are cases in which profit generated by intangibles is less than anticipated. Furthermore, as the criteria for application of the proposed approach are neither sufficiently clear nor objective, they may be broadly interpreted by tax administrations. A question would also arise regarding the appropriateness and timeliness of additionally introducing such an extremely powerful taxation tool in the circumstances where a variety of measures to enforce taxation have already been recommended pursuant to the actions of the BEPS Action Plan.

In view of these, we cannot help feeling that the proposed approach goes beyond what is necessary to achieve the objective. In the ensuing process of finalizing the revisions to Chapter VI of the Transfer Pricing Guidelines, we suggest that the scope of application of the proposed approach be at least narrowed, and that the following matters at a minimum be considered:

(1) Scope and Features of Hard-to-Value Intangibles (HTVI)

Paragraphs 9 and 10 describe the scope and features of HTVI. As these paragraphs merely provide qualitative explanations, we suggest that several examples of anticipated situations be added. For instance, paragraph 9 refers to an absence of “reliable comparables,” a “lack of reliable projections,” and “highly uncertain” assumptions, while paragraph 10 mentions “intangibles that separately are not HTVI but which are connected with the development or enhancement of other . . . HTVI” and “intangibles that are anticipated to be exploited in a manner that is novel at the time of the transfer.” All of these, though, are concepts that can be broadly interpreted. We are strongly concerned that numerous intangibles may in substance fall within the category of HTVI.

(2) Significant Difference

We suggest that a clear definition be provided of the “significant difference” between ex-ante projections and ex-post outcomes referred to in paragraph 13. Each country faces different BEPS concerns and deals with different types of businesses and transactions, which we presume may make it difficult to set uniform criteria. Still, it would be necessary to adopt numerical criteria such as the percentage of deviations and monetary amounts, at least, in order to prevent tax administrations from enforcing taxation subjectively and arbitrarily.
(3) Exemption

Paragraph 14 sets two exemption criteria: one is to provide “full details” of ex-ante projections, and the other is to provide “satisfactory evidence that any significant difference . . . is due to unforeseeable or extraordinary developments or events.” With regard to the first criterion, we suggest that the word “full” be deleted. The term “full details” may allow tax administrations to demand disclosure of source code and other trade secrets that are essentially unrelated to taxation, or to otherwise act in a way that deviates from the norm, in exchange for not taxing the transaction in question.

As for the second criteria, given an undue burden it would impose on taxpayers, either the criterion should be deleted or the burden of proof (or disproof) should rest with tax administrations. When a company has valued transactions using a multifaceted method and submitted the results to the tax administration, the company is considered to have fulfilled its obligation. It would be excessive to impose upon the company any more burden of proof. Furthermore, the word “satisfactory” needs to be clarified because what constitutes “satisfactory” evidence is unclear. (Similarly, although paragraph 12 refers to “where the tax administration is able to confirm the reliability of the information,” it is not clear in what situations tax administrations are viewed as able to make such confirmation.)

In addition, consideration should be given to incorporating the following three elements into the exemption criteria:

(i) Restricting the scope of application to transfers to low-tax jurisdictions

As the proposed approach is presented as part of the BEPS Project, its application should be restricted to the transfer of HTVI to a low-tax jurisdiction. In fact, the majority of cases to which the proposed approach will apply are expected to involve such transfers. However, it may be difficult to revise the Transfer Pricing Guidelines in a manner that restricts their application to particular jurisdictions. If that is the case, the scope of application of the proposed approach may be properly narrowed by formulating the criteria in such a way that the approach will in substance apply to transfers to low-tax jurisdictions only.

Specifically, one possible option to achieve this is to restrict the scope of
application to transactions in which the linkage between the existence of HTVI and the ex-post profit levels is clear. When HTVI has been transferred to a low-tax jurisdiction, especially to a tax haven, it is safe to assume that the degree of the contribution of factors other than HTVI to the profit levels is relatively low, and therefore that identifying the correlation between HTVI and the profit levels is comparatively straightforward. By contrast, in the case of transfers to non-low-tax jurisdictions that include advanced industrialized countries, we assume that the profit levels cannot be explained by HTVI alone because there are other conceivable reasons, such as a new owner of HTVI having added value.

(ii) Excluding a transaction once a certain period has passed after its implementation

With the business environment changing daily, it is rather normal that developments not factored into initial projections arise. To prevent taxpayers from suffering unpredictable tax consequences for a long period of time, a transaction should be excluded from the scope of application of the proposed approach once a certain period of time has elapsed since the transaction was entered into.

(iii) Considering companies’ ex-post adjustments and adopting a method that focuses on shareholding

We assume that the proposed approach will obviously not apply to cases in which a company has voluntarily adjusted profit levels among the associated enterprises using a residual profit analysis and other methodologies. The Public Discussion Draft, though, appears to provide no clear explanation on this point. As it would be excessive for a tax administration to make an adjustment according to the ex-post outcomes on top of the voluntary adjustment already made by the company, this point should be added to the exemption criteria or otherwise clearly stated.

Consideration should also be given to adopting a method whereby the application of the proposed approach will be more focused on transactions that have a greater risk of involving arbitrariness. For example, it is conceivable to restrict its application to transactions conducted between the parent and its subsidiary that is wholly owned and directly controlled by the former.
(4) Dispute Resolution and Accumulation of Cases

If the proposed approach were to be adopted, it would become part of Chapter VI of the Transfer Pricing Guidelines. In that event, every effort should be made to ensure that any double taxation resulting therefrom is resolved, in accordance with the provisions of Articles 9 (Associated Enterprises) and 25 (Mutual Agreement Procedure) of the OECD Model Tax Convention, as a matter involving the application of the arm’s length principle—although it is debatable whether the approach constitutes a measure consistent with that principle.

Additionally, from the perspective of preventing arbitrary enforcement, it is crucial to accumulate cases of taxation, share them internationally, and thereby refine the application criteria.

Sincerely,

Subcommittee on Taxation
KEIDANREN
Comments on the Discussion Draft on Hard-to-Value-Intangibles

Professionals in the Global Transfer Pricing Services practice of KPMG welcome the opportunity to comment on the Organisation for Economic Co-operation and Development’s (“OECD”) Discussion Draft titled “BEPS Action 8: Hard-to-Value-Intangibles” (the “Discussion Draft”).

As the name indicates, hard-to-value-intangibles (“HTVI”) are just that – hard to value – which makes determining the arm’s-length price a challenge for such intangibles. The OECD is therefore to be commended for tackling a difficult and important issue where appropriate guidance will have high value to taxpayers and tax authorities alike. The Discussion Draft provides a useful start in this direction.

From a practical standpoint, much of the challenge with HTVI is the uncertainty created for taxpayers and tax authorities. This uncertainty reinforces the importance of the OECD’s work on making dispute resolution mechanisms more efficient. In addition, KPMG recommends that the OECD make the HTVI guidance clearer in some instances and less open to differing interpretations. We provide some specific comments below.

Basic Concepts

The OECD guidance on HTVI appears to be driven off two key concerns:

1) Uncertainty as to the value of the intangibles: The value of intangibles can be difficult to determine because of a lack of direct pricing information and/or because the forecast benefits from the use of intangibles are uncertain; and

2) There is the potential for significant information asymmetries between the taxpayer and tax authority; e.g., taxpayers may have access to substantially more information than tax authorities.
HTVI transfers are common in transactions between unrelated parties. In such exchanges, known uncertainties are taken into account in a variety of ways. They may be modeled explicitly into the determination of cash flows (e.g., the expected value of future profits of a Phase I pharmaceutical compound generally explicitly reflects the risk of failing Phase II and Phase III clinical trials), or through variations in discount rates (e.g., higher discount rates are applied to projected cash flows for products that are new and have an uncertain market acceptance than for the projected cash flows for established products); or through contingent payment arrangements of one type or another (fixed royalty rates; profit splits; milestone payments that are contingent upon specific events). When such known uncertainties are factored into pricing, substantial variations between projected cash flows and actual cash flows are common, and may in fact be inevitable.¹

KPMG’s understanding of the OECD’s guidance is that – but for dealing with issues of information asymmetries (commented on below) - transfers of HTVI intangibles among controlled parties should generally reflect the same considerations as between uncontrolled parties. KPMG agrees with this general principle, and believes it should be stated more clearly than it is in the current draft guidance.

Information asymmetry exists when (i) the taxpayer has more information than is available to the tax authorities affected by the transaction and (ii) the incremental information has an impact upon pricing. For example, if the taxpayer has information that the likelihood of approval for the specific compound involved in the controlled transaction is 70% rather than the 50% that is implied based on the use of data on historic acceptance rates, but uses the 50% probability rather than the more reliable 70% probability in determining the value of the transfer, the taxpayer may be misstating the value because it is failing to incorporate facts that are known to it but not to the tax authority.

The Discussion Draft argues that it is difficult for a tax authority to evaluate the reliability of information used by a taxpayer to price a HTVI given the information asymmetry between tax authorities and taxpayers. Thus, a tax authority may consider ex post evidence about actual financial outcomes to gauge the reasonableness of the ex ante price determined by the taxpayer. The Discussion Draft allows ex post evidence to be used in situations where the difference between ex ante projections and ex post outcomes is “significant,” and where such a difference is due to events that were foreseeable at the time of the transaction.

KPMG has several concerns with this conclusion. First, as a technical matter, the existence of information asymmetries does not necessarily distort the arm’s length price – arm’s length parties may face similar information asymmetries in their negotiations. But this is a technical point only; KPMG understands that tax authorities can reasonably expect that intercompany pricing should be based on the assumptions about which both parties are equally well informed.

That said, this is an evidentiary issue rather than a conceptual issue. It is reasonable for a tax authority to ask that taxpayers be able to explain significant differences between forecast and actual

¹ In the case of a pharmaceutical compound that has a 50% chance of receiving market approval, actual results will be either 100% greater or lower than the risk-adjusted projected results used in the forecasts, even if all the individual assumptions underlying the forecasts are 100% accurate.
results, including an explanation of how known uncertainties were taken into account and why the forecasts employed were reliable inputs even though the actual results are significantly different from the forecasts. But if the taxpayer can provide such an explanation, including an evaluation of how known uncertainties were factored into the pricing of the controlled transaction, then tax authorities should accept the pricing based on ex ante expectations. In any event, this should be – in the vast majority of cases – an inquiry into whether the assumptions that were used by the taxpayer were appropriate, and should not lead to a re-characterization of the transaction without the presence of other factors as discussed below.

In the sections below, KPMG discusses areas where it believes greater clarity is needed than exists in the Discussion Draft.

**Importance of Interaction with Section B of Ch. VI of the OECD Transfer Pricing Guidelines (“OECD Guidelines”)**

The Discussion Draft correctly indicates that HTVI issues frequently arise in the case of transfer of early-stage intangibles. In those cases, the resulting realized income will be importantly dependent on the success or failure of subsequent efforts to develop, enhance, maintain, protect and exploit (DEMPE) the intangibles. This dependency has important implications for any use of ex post evidence for valuing the transferred intangibles.

The OECD has already issued important guidance in Section B of Ch. VI of the OECD Guidelines (“Chapter VI”) on the attribution of income arising from intangibles. That guidance emphasized the potential importance of DEMPE functions in attribution of intangible income. The OECD must take care that its guidance on HTVI be consistent with other guidance so that intangible income is consistently allocated between pre-existing intangible rights and subsequent DEMPE activities.

The guidance on HTVI should make it clear that any use of ex post evidence should be consistent with the general guidance in Chapter VI. Chapter VI notes that certain important functions will have special significance in determining which group members are entitled to returns from an intangible. For self-developed intangibles, or intangibles that serve as a platform for further development, these more important functions may include design and control of research and marketing programs, direction of and establishing priorities for creative undertakings including determining the course of “blue-sky” research, control over strategic decisions regarding intangibles development programs, and management and control of budgets. (Paragraph 6.56 of Chapter VI).

For intangibles that are transferred at an early stage of development, by definition, there is significant additional development that takes place after the transfer of the partially developed intangible. Chapter VI may, therefore, assign significant value to the locations performing the important functions related to the ongoing development, enhancement, maintenance, protection and exploitation of the intangible.
The OECD should emphasize that any use of *ex post* evidence to recompute the upfront value of the partially developed intangible must account for income attributable to ongoing development, maintenance and exploitation of the intangibles under the principles of Section B of Ch. VI. The OECD should note that inconsistent application of these principles by tax authorities would constitute double-taxation where the same income is attributed to both the pre-existing intangibles and to the subsequent development, maintenance and exploitation thereof. KPMG notes again the fundamental importance of improved dispute resolution procedures to address the likelihood of conflicting judgments by tax authorities and taxpayers on these matters.

This issue may take on added importance to the extent that taxpayers, seeking to comply with evolving OECD guidance in this area, undertake transactions to more closely align legal rights to intangibles with the important DEMPE functions of their businesses.

**Recharacterization of Transactions**

The Discussion Draft notes that if the use of *ex post* evidence is found to be appropriate, then a tax authority could use it to inform the determination of arm’s-length pricing arrangements. These could take the form of contingent pricing arrangements, short-term agreements with price adjustment clauses or arrangements involving periodic milestone payments that would have been made by independent parties at the time of the transaction.

As an obvious first point, recharacterizing an HTVI transaction does nothing to reduce the uncertainty that existed at the time that the transaction was entered into, or the fundamental difference between expected *ex ante* and actual *ex post* results – it simply shifts the risk among the different participants to the transaction. Therefore, recharacterization is only appropriate when the initial allocation of risks would not have been agreed by parties at arm’s length.

KPMG notes that third parties can enter into many different types of arrangements in identical circumstances. Thus, when transferring an early stage intangible, for instance, some parties might agree to royalty payments; others may agree to renegotiation clauses; yet others may agree to upfront fees with milestone payments or just lump sum payments. What is most important is that the overall payment be acceptable to both parties to the transaction at the time that the transaction was entered into given the terms of their agreement. Therefore, to the extent possible, the adjustments should be limited to those that would result if the transaction terms are respected, and different assumptions are used in the computation of the prices of that transaction.

The Discussion Draft appears to give tax authorities the authority to freely revise intercompany arrangements. While it is true that arm’s-length arrangements should inform the intercompany pricing, taxpayers should have the flexibility to structure their transactions in ways that are best for their business. The Discussion Draft should make it clear that while tax authorities may use alternative third-party payment arrangements to inform arm’s-length prices, in the vast majority of cases this should simply lead to an adjustment in assumptions. Tax authorities should not have the
ability to require taxpayers to structure their HTVI transfers differently, provided that the initial arrangement is one that would have been agreed to at arm’s length.

Responses to Specific Points Raised in the Discussion Draft

The OECD asked for comments on four specific questions in the Discussion Draft. KPMG’s responses to these questions are provided below.

Are there Mechanisms that Could Provide Greater Certainty to Taxpayers Regarding the Treatment of HTVI?

As discussed above, HTVI are commonly transferred in transactions between unrelated parties, and there are established approaches for dealing with the uncertainty around value. The key issues that the OECD has identified (information asymmetry between taxpayers and tax authorities) is evidentiary – how can taxpayers show that the forecasts and other assumptions that they used were reliable when there are significant differences between expected and actual results. This is not fundamentally different from most transfer pricing issues, and therefore taxpayers should be able to support the pricing around HTVI in essentially the same way that they support other transfer pricing analyses, namely:

1) By establishing that the contractual arrangements are consistent with those that would be agreed between unrelated parties, taking into account related guidance in Ch. I of the OECD Guidelines and elsewhere; and

2) By establishing that the facts and assumptions used in pricing HTVI were the most reliable available at the time of the transaction, including a discussion of how known uncertainties were factored into the analysis.

Are there Additional Exemptions that Should be Added to Those Listed in Paragraph 14?

KPMG believes that there should be a statement of general principles in addition to the specific exemptions provided in Paragraph 14. Suggested wording could be: “The approach described in the section will not apply if the taxpayer can show that terms of its business arrangements and the assumptions and facts used in its analysis are consistent with those that would be used by uncontrolled parties. Some specific examples of such evidence might include:”

Other examples of specific factors that should be taken into account in evaluating the reliability of the projections used by the taxpayer would be evidence that they are used as the basis of decision-making by taxpayers; e.g., that they were used as the basis of board approvals for significant investments.

KPMG also recommends that the guidance include a time limit on the comparison of *ex ante* projections and *ex post* results. Tax authorities should not have unlimited authority to adjust prices several years after the transaction has taken place.
**Whether the Concept of “Significant Difference” as Used in Paragraph 13 Should be Further Defined**

The Discussion Draft allows the use of *ex post* evidence to adjust prices if there is a “significant” difference between the *ex ante* projections and the *ex post* outcomes related to the HTVI. KPMG has the following observations related to the difference between *ex ante* and *ex post* outcomes of a HTVI:

- By definition, there will be significant uncertainty related to the expected benefits of a HTVI *ex ante*. The *ex ante* projections will be “expected” or probability-weighted projections of benefits. The *ex post* outcomes, on the other hand, will be the actual realization of benefits once the uncertainty surrounding the HTVI has been resolved. Thus, almost by definition, the *ex ante* expected projections will be “significantly different” from the *ex post* realized outcomes. For example, *ex ante*, a HTVI may have two possible expected benefits – zero or 1,000,000 – with equal probability. The *ex ante* expected benefit is therefore 500,000. *Ex post*, once the uncertainty around the HTVI is resolved, suppose the outcome achieved is the 1,000,000 that had been anticipated with a 50 percent probability. If the *ex ante* projection of 500,000 is compared with the *ex post* outcome of 1,000,000 in a naïve comparison of the *ex ante* and *ex post* outcomes, there might appear to be a “significant” difference.

- Without more clarity around what is meant by a “significant” difference between *ex ante* projections and *ex post* outcomes, it is likely that almost every HTVI will be caught in the net. It will also mean that a finding of “significant” difference will become the default position with the burden of demonstrating why there should be no change to the *ex ante* position falling heavily on the taxpayer.

- KPMG recommends that the standard for using *ex post* evidence should not be a simple comparison of *ex ante* projections and *ex post* outcomes, which, as noted above, is likely to implicate almost every HTVI valuation and lead to prolonged exams and controversy. Instead, the basis for allowing *ex post* evidence should directly address the concerns around information asymmetry noted by the OECD. Thus, if a taxpayer relies on projections created for valid business purposes other than transfer pricing and can demonstrate that those existed at the time of the HTVI valuation, then tax authorities should not be able to use hindsight to adjust them irrespective of the actually realized benefit of the HTVI.
What Further Matters would be Useful to Consider in Any Follow-up Guidance on Practical and Consistent Implementation of the Approach?

This letter addresses several points for additional guidance above. To reiterate, while KPMG agrees with the general principle that transfers of HTVI intangibles among controlled parties should reflect the same considerations as between uncontrolled parties, we believe it should be stated more clearly than it is in the current draft guidance. Not doing so will lead to greater controversy in transfer pricing of HTVI.

As noted above, the HTVI guidance should be consistent with other Chapter VI guidance so that intangible income is consistently allocated between pre-existing intangible rights and subsequent DEMPE activities. The OECD should include an example showing how attribution of income to DEMPE functions will affect any use of ex post results.

The Discussion Draft should also make it clear that while tax authorities may use alternative third-party payment arrangements to inform arm’s-length prices, they should not have the authority to require taxpayers to structure their HTVI transfers differently.

In addition, the Discussion Draft uses several other terms such as “novel” and “satisfactory evidence” that are subjective too. KPMG recommends that future OECD guidance on HTVI make these terms clearer.

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About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have more than 162,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.
Dear Mr. Hickman,

In response to the invitation of the OECD to interested parties to provide comments on the public discussion draft on “Action 8: Hard-to-Value Intangibles” (the “Discussion Draft”), please find in this letter the comments on the Discussion Draft on behalf of Loyens & Loeff N.V.¹ (“Loyens & Loeff”, “we” or derivative terms).

Loyens & Loeff appreciates the work done by the OECD in developing revisions to Section D.3 of the BEPS Report containing Guidance on Transfer Pricing Aspects of Intangibles. We have examined with great interest the proposed revisions, and we welcome the opportunity to submit comments on the Discussion Draft.

The comments we provide in this letter are our own comments as tax professionals. They do not represent the comments of particular clients.

**Suggestions**

We have five suggestions to improve the Discussion Draft, being (i) adding a flow chart of the relevant conditions to determine whether tax administrations may consider ex post evidence, (ii) a suggestion to reflect that the Discussion Draft does not fit within the arm’s length principle and that it can best be labelled as a special measure, (iii) a suggestion to define in more detail the concepts of ‘significant differences’, ‘unforeseeable events’, ‘reliable projections’, and ‘highly uncertain’ (iv) a suggestion to include time limitations, and (v) a suggestion to include a safe harbour. We are hopeful a revised Discussion Draft would offer a useful way to reduce the risk for time consuming discussions with tax administrations.

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¹ As a leading firm, Loyens & Loeff is the natural choice for a legal and tax partner if you do business in or from the Netherlands, Belgium, Luxembourg, and Switzerland our home markets. You can count on personal advice from any of our 900 advisers based in one of our offices in the Benelux or in key financial centres around the world. Thanks to our full-service practice, specific sector experience and thorough understanding of the market, our advisers comprehend exactly what you need.
(i) Flow chart of the relevant conditions

After carefully reading the Discussion Draft, we derive the following flow chart that describes the determination whether tax administrations may consider ex post evidence in assessing transactions involving the transfer of intangibles or rights to intangibles:

If this visualization is correct, we understand the Discussion Draft would offer a useful way to reduce the risk for time consuming discussions with tax administrations. If this visualization is incorrect, we recommend including a correct chart in the Discussion Draft.

(ii) Labelling Discussion Draft as special measure

We do not agree that the measures proposed in the Discussion Draft fit within the arm’s length principle. In transactions between unrelated parties, parties, unfortunately, cannot use ex post evidence. Therefore, we advise labelling the proposed measure a “special measure”.

May consider ex post evidence

May not consider ex post evidence
The Discussion Draft contains several statements that do not fit within the arm’s length principle. The Discussion Draft seems to conclude that a price adjustment clause may be imputed by tax administrations. To reach this conclusion, the Discussion Draft uses “incidental” observations about the transfer of hard-to-value intangibles between independent enterprises, and subsequently suggests applying these observations under “all” circumstances.

For example, para. 3 of the Discussion Draft states that “Independent enterprises might find that pricing based on anticipated benefits alone does not provide adequate protection against the risks posed by the high uncertainty in valuing the intangible. In such cases independent enterprises might adopt shorter-term agreements, include price adjustment clauses in the terms of the agreement, or adopt a payment structure involving periodic milestone payments to protect against subsequent developments that might not be sufficiently predictable.”

While this might be true for some enterprises, there are also examples of independent enterprises acquiring hard-to-value intangibles for a fixed price. Nonetheless, the Discussion Draft uses this general notion in para. 5 to assume that under the mentioned conditions all independent enterprises would agree on price adjustments:

“If independent enterprises would have insisted on a price adjustment clause, the tax administration should be permitted to determine the pricing on the basis of such a clause.”

The application of the arm’s length principle is based on the notion of what independent enterprises do. There is no requirement under the arm’s length principle to do what some independent enterprises potentially would do. It is very well possible that independent enterprises allocate all risks of diversions from ex ante projections to the party acquiring the intangible. Such allocation of risks would be reflected in the price of the intangible. It would not automatically be needed to reflect such uncertainty by agreeing on a price adjustment clause. The Discussion Draft should not result in a situation in which the seller of an intangible has to incur the consequences of all foreseeable risks (a risk is not a certainty).

We, therefore, suggest that the OECD clarifies that, under the at arm’s length principle, uncertain valuations as such do not justify ex post price adjustments, nor that they justify the imputation of price adjustment clauses.

As we are hopeful that using ex-post information might offer a useful way to reduce the risk for time consuming discussions with tax administrations anyway, we advise labelling the proposed measure a “special measure.”

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2 The situation where a taxpayer does what most independent enterprises do, does not reflect situations which will cause discussions in practice.
(iii) Define in more detail the concepts of ‘significant differences’ ‘unforeseeable events’, ‘reliable projections’, and ‘highly uncertain’

The Discussion Draft uses undefined concepts such as ‘significant differences’ and ‘unforeseeable events’. With regard to the latter, the OECD seems to suggest in the example in para. 15 that events can only be unforeseeable if they arise from external circumstances, such as natural disasters or bankruptcy of competitors. In our view, the higher demand for products incorporating the intangible may also be unforeseen if they arise out of –for example– an unexpected popularity of the product that is not caused by extraordinary events such as natural disasters. The situation that a product has reached its ‘tipping point’ earlier than could be reasonably expected should also be considered as an unforeseen event.

With regard to the term ‘significant differences’, we suggest implementing a percentage deviation of the actual outcomes from the ex ante projections (e.g. 50%). Above this percentage, differences would be qualified as significant. If a taxpayer prepared simulations of possible outcomes, it could be considered to allow a difference of two standard deviations.

The risk of using vague concepts is that tax courts in various jurisdictions will perceive the ambiguous guidance as a less reliable source of information for resolving tax disputes. This will lead to differences in interpretation and application of the arm’s length principle between jurisdictions, leading to more instead of less opportunities to exploit differences between countries. It would also diminish the value the OECD Transfer Pricing Guidelines (“Guidelines”) traditionally have had in the practical application of the arm’s length principle.

In addition, some tax administrations will be tempted to argue that more profits should be allocated to their jurisdiction, provoked by the ambiguous guidance on when ex post information may be used. Not being able to rely on unambiguous guidance, many uncertainties will arise for MNEs, invoking more disputes with tax authorities, undermining the tax system’s effectiveness and efficiency.

Other tax authorities might be tempted to attract new investments by offering tax breaks, ironically also enabled by the ambiguous guidance which leave them room to opportunistic but defendable interpretations of the Guidelines, also undermining the tax system’s effectiveness and efficiency.

(iv) Time limitations

The Discussion Draft does not mention anything about time frames within which tax administrations may compare actual outcomes with financial projections. We suggest limiting this possibility to the period for which ex ante projections can reasonably be prepared. All significant differences after such a period should be automatically qualified as unforeseeable differences.
(v) **Safe harbour**

We expect that the Discussion Draft creates a large administrative burden for taxpayers performing transactions involving intangibles. For example, taxpayers are to document carefully how the pricing of the transfer of an intangible has been established, which risks have been identified, and how these risks have been quantified. This requires for example cash flow analysis and simulations.

Based thereon, we suggest including a safe harbour rule for situations where a cost-benefit analysis indicates that the additional tax revenue that would be collected does not justify the costs and administrative burdens of avoiding the application of the special measure.

Yours sincerely,
Loyens & Loeff

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18 June 2015  
Our ref MJZ/EYW

Dear Mr Hickman,

We write in response to the request for comments on the Discussion Draft on Arm’s Length Pricing of Intangibles when Valuation is Highly Uncertain at the Time of the Transaction and Special Considerations for Hard-To-Value-Intangibles (“HTVI”).

Overall, we believe that the mechanism described in the Discussion Draft, which involves measuring the value of HTVI using an anticipated benefit approach creates a significant level of uncertainty for both the taxpayer and the tax administration. In our opinion, using an expenditure based approach to value HTVI will often be the best available arm’s length approach, and should reduce the level of uncertainty for both the taxpayer and the tax administration. In addition, we also believe that the Discussion Draft requires further clarity with respect to valuation techniques that can be used to value HTVI.

The detailed comments that we provide below are in relation to the additional points described in the Discussion Draft:

Additional points 1 and 4

The Discussion Draft defines the term HTVI as “intangibles or rights to intangibles for which, at the time of their transfer in a transaction between associated enterprises, (i) no sufficiently reliable comparables exist, and (ii) there is a lack of reliable projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain.” Furthermore, the Discussion Draft explains that pricing should be based on anticipated benefits and connected parties may adopt shorter term agreements with price adjustment clauses or payment structures.

We agree that permitting the use of shorter term agreements with price adjustment clauses or payment structures should reduce the risk of payment outcomes being mismatched with value and this approach does comply with the arm’s length principle. Moreover we also believe that optionality clauses such as providing the disadvantage connected party the right to renegotiate the pricing terms or terminate the contract may provide protection against the risk posed by the high uncertainty in valuing the intangible.

We are concerned that carrying out a valuation of a HTVI for which projected cash flows cannot be measured reliably, using the anticipated benefit approach may not be practical. The fact that the projected cash flows cannot be measured reliably for HTVI, suggests that value creation of the HTVI cannot be measured reliably because of the difficulty in projecting the outcome of the HTVI. In practice, for highly uncertain projects (for example projects that include the development, enhancement, maintenance and exploitation of HTVI) projecting cash outflows (i.e. expenditures) is significantly easier.
and more reliable than measuring the cash inflows (i.e. the anticipated benefits) mainly because of the uncertainty in the outcome (i.e. the anticipated benefits) of the project. For such highly uncertain projects, independent parties would usually form pricing agreements based on an expenditure approach rather than using an anticipated benefits approach. Therefore in accordance with the arm’s length principle two connected parties should also be able to form pricing agreements using an expenditure approach for highly uncertain projects. We believe that for the arm’s length pricing of intangibles when valuation is highly uncertain at the time of the transaction and for HTVI, an expenditure based valuation would be an arm’s length valuation approach. Moreover, we believe the expenditure approach would provide a better indication of value creation when compared to measuring the anticipated benefits for a transaction whose projected cash flows lack reliability.

In our opinion, the mechanism described in the Discusssion Draft is complicated and it also creates uncertainty for both the taxpayer and the tax administration. The mechanism creates uncertainty for the taxpayer because the taxpayer is expected to value the HTVI using an anticipated benefits approach notwithstanding the deficiency in relevant cash flow projections. Furthermore, if the ex-ante pricing arrangements differ from the ex-post valuation the tax administration is permitted to use the ex post levels to determine the nature of the ex-ante pricing arrangement, which we believe will create uncertainty for the tax payer. However, we agree that using short term agreements which include pricing adjustment clauses and payment structures should reduce the uncertainty faced by tax payers.

Paragraphs 5 and 6 are examples that indicate some weaknesses to the mechanism. Paragraph 5 states that “if independent enterprises would have insisted on a price adjustment clause, the tax administration should be permitted to determine the pricing on the basis of such a clause”. This statement seems to provide the tax administration an unreasonable amount of authority on a highly judgemental subject which may lead to an increase in disputes between tax payers and the tax administration. Paragraph 6 demonstrates that the tax administration may also find it difficult to value intangibles that are highly uncertain at the time of the transaction which may lead to an increase in uncertainty for the tax administration. The fact that these transactions are highly uncertain implies that projected cash flows and anticipated benefits may be difficult to measure and therefore small changes in the underlying assumptions may have a significant effect on the valuation. Differences in profit level calculations between the tax administration and tax payers may occur because of different underlying assumptions that are highly subjective. Furthermore, paragraph 6 suggests that the tax administration also faces uncertainty because the mechanism seems to lead to asymmetric information. We believe that the mechanism detailed in the Discussion Draft will lead to high levels of uncertainty and an increase in disputes between taxpayers and the tax administration. In our opinion, using a simpler mechanism, where the pricing arrangements for HTVI are valued using an expenditure based approach rather than the anticipated benefits approach, should reduce the uncertainty and may even reduce the asymmetric information problem expressed in the Discussion Draft.

We understand that an expenditure based approach does have its weaknesses for example it can be argued that an expenditure based approach may not be in line with value creation. However, we believe that for HTVI whose cash flows cannot be measured reliably, the expenditure approach provides a better indication of value when compared to an anticipated benefits approach. We note that an expenditure based approach may be exploited by tax payers for an unreasonable length of time. To tackle such issues the Discussion Draft should consider permitting the use of an expenditure based approach to value HTVI for a limited period of time beyond which an anticipated benefits approach should be adopted. Ideally, beyond the limited period of time the transaction would no longer be considered as a HTVI but instead an intangible whose anticipated benefits can be measured reliably and/or any of the five OECD transfer pricing methods can be applied to the transaction. We also believe that if an expenditure based approach is implemented, it should only be used for exceptional circumstances where it is truly the case that the transaction is in fact a HTVI.

The guidelines should state that using valuation techniques based on projected cash flows is likely to be the most appropriate method for pricing HTVI but only where the cash flows can be predicted with reasonable certainty. It should also recognise that estimating value using valuation techniques can be volatile because small changes in the underlying assumptions can have significant effects on value.
Additional point 2

In relation to paragraph 14, we believe that point 1) requires more detail by explaining that the taxpayer should also provide details of the underlying assumptions in relation to discount rates, growth rates, the useful life of the intangible and the tax effects of the transaction (ref: paragraph 6.154 of the BEPS paper, Guidance to Transfer Pricing Aspects of Intangibles 16 September 2014).

Additional point 3

In relation to paragraph 13, the Discussion Draft should define the notion of “significant difference”. We believe that a mechanism that could be used to determine the difference between the ex-ante financial projections and ex-post financial outcomes could be based on a quantitative predetermined significance level derived by a statistical analysis using existing real transactional data. The same quantitative predetermined significance level should apply to all types of HTVI. We believe that a quantitative predetermined significance level will reduce the level of disputes between taxpayers and the tax administration.

Conclusion

In our opinion, the anticipated benefits mechanism detailed in the Discussion Draft used to value HTVI lead will to significant levels of uncertainty. In addition, we believe the mechanism is not practical for all but the very highest value transactions because for most transactions the cost of conducting such a complex transfer pricing analysis is likely to outweigh the associated benefits. We believe that using an expenditure based approach, as above, to value HTVI would reduce the level of uncertainty and is a more practical and cost effective way to apply the arm’s length. Furthermore, we believe that the Discussion Draft requires further clarity with respect to the valuation techniques that can be used to value HTVI.

Yours sincerely

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June 18, 2015

BEPS Action 8: Hard-to-Value Intangibles ("HTVI")\(^1\)

Comments by Pat Breslin of NERA Economic Consulting\(^2\)

Dear Mr. Hickman,

I would like to thank you and the members of the relevant OECD committees and working parties once again for the opportunity to comment on the above-mentioned document.

In the author’s view, the question of whether or not an intangible is “hard to value” or its valuation is “highly uncertain” usually revolves around its stage of development. Thus in considering this complex issue, special attention should be given to:

1. the stage of development of any transferred intangible, and
2. the implications of the current stage on the expected value and risks associated with the intangible—taking into account risks that have already been resolved (\textit{ex post}) and those yet to be resolved (\textit{ex ante}).

Obviously, risks that have already been resolved cannot be allocated \textit{ex post}, contractually or otherwise. At arm’s length, when parties have assumed risks that have produced successful outcomes—such as completing a critical stage of development—they demand the corresponding return in any transactions involving the underlying assets. The arm’s length price reflects the fact that certain risks have been resolved and value has been created in assuming them.

Thus, the parties to contracts will take into account what is already known at the time that the contract is executed. However, as the draft makes clear in paragraph 3, \textit{ex ante} risks are often allocated between contracting parties through various terms and provisions. For example, payment

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\(^1\) Public Discussion Draft revisions to Section D.3 of Chapter VI of the OECD Transfer Pricing Guidelines (the “guidelines”) dealing with transfer pricing of intangibles, issued June 4, 2015. Hereinafter, referred to as the “draft” or “Discussion Draft.”

\(^2\) These comments represent the independent views of the author and do not necessarily reflect the views of NERA Economic Consulting, or any of the author’s colleagues. The author would like to thank Simon Wu and David Stark of NERA in Washington, DC for their helpful review and comments.
structures may withhold payments to a licensor of an intangible until it has reached certain milestones in its development.

The earlier the stage of development at the time of its valuation, the greater the uncertainty (i.e., risk) regarding the success of subsequent development stages that are necessary for an intangible to realize commercial success. Often, this uncertainty also impacts the value of investments that are closely related to the intangible. In the author’s view, the list of common features of HTVI identified in paragraph 10 of the draft could equally apply to early stage intangibles, as they also are:

- partially developed at the time of the transfer;
- not anticipated to be exploited commercially until several years following the transaction;
- [often] connected with the development or enhancement of other intangibles which fall within the category of HTVI; and
- anticipated to be exploited in a manner that is novel at the time of the transfer.

Because the number of milestones needed for success is also greater at earlier stages, the risks associated with meeting each such milestone are compounded, again reducing the probability of overall success. (These effects are illustrated in the coin flip game model discussed below.) Additional features of early stage investments in intangibles include:

1. longer time horizons over which uncertain outcomes may prove unfavourable—that is, more could go wrong;

2. multiple interdependent stages (e.g., patent approval, regulatory approval, product tests, consumer or end-user acceptance)—each of which must produce successful outcomes in order for the project to succeed;

3. a “make or break” quality concerning any stages that are interdependent; and

4. risks that business people and investors may control and those that they do not control—such as the actions of their competitors.

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From an investment standpoint, the “uncertainty” endemic to the stages of intangible development is effectively synonymous with risk. Thus, early stage investments in intangibles are riskier than later stage investments, even with respect to the same intangibles. Correspondingly, investors demand higher returns on early stage investments in intangibles relative to later stage investments.

These concepts are illustrated in the game model discussed below, which also provides a useful framework for discussing many relevant aspects of the Discussion Draft. While this game model has been discussed by the author in other related contexts and comments, the model is adaptable and able to illustrate additional issues specific to this discussion draft.

Risk, expected value and actual returns at different stages

In Figure 1 below, we see a game model that simulates the relationship between risk, the expected value of an investment (ex ante) and actual returns on that investment (ex post) across different stages.

In the game, a player (Player 1) that buys a $5 ticket can win $100, but only if a coin flips “heads” four straight times. If “tails” occurs once, the player loses the cost of his $5 ticket. Player 1 has a 6.25 percent chance of winning $100. Thus, before the first flip, the expected value of the ticket is $6.25—as shown in the ex ante column.

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4 This game model was originally introduced by P. Breslin in comments on draft revisions to Chapter I of the guidelines concerning risk. For a detailed description of the game model, see Breslin, “Coin Flips, Rational Decisions and Risk.” Tax Management Transfer Pricing Report 23 No. 20 (2015).
Assume that a second player (Player 2) can buy the ticket from the first player, and thus buy into the game at later stages, once the outcomes of prior stages are known—that is, *ex post*. Player 2 would only buy this game ticket if all prior stages had produced “heads.” A game ticket that realizes “tails” at any prior stage is worthless—exhibiting the “make or break” nature of each stage in the game and the fact that the four stages are interdependent.

It is important to note that in Row A, the expected value of the ticket changes when the outcome of each stage is certain. Thus, *risk* is reduced and value is created. If the first flip is heads, the expected value increases to $12.50. In stages 2 and 3, the value grows to $25 and $50, assuming “all heads.”

These returns relate to Player 1’s risk—and they are reflected in the price that Player 2 would pay if he were to buy the ticket at these later stages. In Row B, note that Player 1 could make *five to ten times* his initial investment.

As shown in Table 1 below, these multiples reflect arm’s length returns that venture capital (VC) funds make on *individual* R&D start-up companies when they are acquired by other companies.

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5 Figure 1 was originally included in the P. Breslin presentation, *Comments on the OECD Public Discussion Draft “BEPS Actions 8, 9, 10: Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures),”* presented before OECD Committee on Fiscal Affairs working parties and country delegates at public consultation hearings on draft revisions to Chapter 1 of the OECD Transfer Pricing Guidelines. Paris, March 19-20, 2015. Hereinafter referred to as “Breslin March 2015 OECD presentation.”
While VC funds generally target returns greater than ten times ("10x") money invested, Table 1 illustrates that in this period they succeeded in only 25% of cases.

Table 1

Recent Return Multiples from VC-M&A Exits

<table>
<thead>
<tr>
<th>Percentage of Exits by Multiple Range</th>
<th>(1) VC exit multiples</th>
<th>(2) % of VC-M&amp;A exits</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. 1x or less</td>
<td></td>
<td>25%</td>
</tr>
<tr>
<td>B. 1x to 4x</td>
<td></td>
<td>28%</td>
</tr>
<tr>
<td>C. 4x to 10x</td>
<td></td>
<td>22%</td>
</tr>
<tr>
<td>D. 10x or more</td>
<td></td>
<td>25%</td>
</tr>
<tr>
<td>E. BEPS 10x+</td>
<td></td>
<td>100%</td>
</tr>
</tbody>
</table>

Like in the game, a start-up’s prior success explains the later stage price at which it sells. In the VC industry, this return compensates the early stage risks collectively assumed by the entrepreneurs and the VC investors, as well as the risk management capabilities and expertise of the VC fund managers (i.e. the “general partners” or “GPs”), as discussed further below.

However, when tax base erosion and profit shifting (referred to as “BEPS”) occurs with respect to transfers of HTVI between affiliates of a multinational enterprise (“MNE”), success rates are unrealistic. This is shown in the bottom row of Table 1 above.

Repeatedly, publicly disclosed information on cases involving intangibles transferred to foreign MNE affiliates suggests that their investments consistently realize returns of 10x or greater—an extraordinary pattern that defies the odds and far exceeds the performance of highly skilled

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professional investors in start-ups that focus on intangible development—*i.e.* the GPs that manage VC funds.

Often, such cases relate to intangibles contributed to R&D-based cost contribution arrangements (or “CCAs”), where MNE affiliates share the costs to further develop existing intangibles that are already in later stages of development and have an installed base of customers, for example. The available facts in such cases indicate that late-stage technology was sold at an early-stage price—as if Player 1 in the game model would sell a Stage 3 ticket worth $50, for only $5 (see Figure 1 above).

Table 2 below shows that, for VC funds, early stage returns were about nine times greater than returns on later stage investments during a recent 15-year period. For example, VC fund early stage investments earned returns of 82.1 percent (Row A, Column 2) while later stage investments earned returns of 9.4 percent (Row B, Column 2).

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7 For a more detailed discussion on intangibles valuation issues in the contexts of CCAs, see P. Breslin comments on “BEPS Action 8: Discussion draft on revisions to Chapter VIII of the Transfer Pricing Guidelines concerning cost contribution agreements,” May 29, 2015. The author would like to take this opportunity to correct a post-review stage editorial error in his May 29 comments on CCAs. Text on page 6 appears to indicate an expected value of $50 for the game ticket at stage 2; text on page 5 appears to imply the same. Obviously, as shown in Figure 1, the expected values of the ticket are $25 at stage 2 and $50 at stage 3.
Meanwhile, in Table 2 Row C we see that returns on VC funds’ total portfolios—i.e. on funds comprising a diversified group of individual investments—earned about 18.7 percent during the same period.

Cambridge Associates LLC (“CA”) compiles these VC indices and also compares them to returns to the S&P 500 index—which CA adjusts to take into account private investment performance attributes, such as cash flows and distributions, under public market conditions. CA shows adjusted S&P 500 index figures of 4.5 percent and 6.1 percent for the periods ending in 2012 and 2013, respectively, comparing them to the figures in Row C columns 1 and 2 above.10

Finally, Figure 2 below labels VC portfolios as “external R&D” and shows that these reflect internal R&D programs of mature companies. For example, each approach to developing

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9 The Cambridge Associates LLC U.S. Venture Capital Index® is an end-to-end calculation based on data compiled from 1,493 U.S. venture capital funds (960 early stage, 165 late & expansion stage, 362 multi-stage and 6 venture debt funds), including fully liquidated partnerships, formed between 1981 and 2013. Returns are pooled end-to-end, net of fees, expenses, and carried interest. Hereinafter referred to as an “end-to-end pooled return.”

10 See references in footnote to Table 2; S&P 500 index figures are drawn from these references.
intangibles leverages the core expertise of key personnel specializing in relevant business and technology domains.

These may include experts in science and technical subjects working on a company R&D project as well as experts in financing and managing such investments. Both skill sets are endemic to companies pursuing “internal R&D,” while in the case of VC-funded “external R&D” this expertise may be distributed between the entrepreneurs in the start-up and the GPs of the VC fund. In either case, each approach leverages risk management skills and real option value across a diversified portfolio of R&D projects.

![Figure 2](image)

**Figure 2**

**Characteristic Features of Investing in Hard-to-Value Intangibles**

<table>
<thead>
<tr>
<th>Internal (in-house) R&amp;D</th>
<th>External (VC-funded) R&amp;D</th>
</tr>
</thead>
<tbody>
<tr>
<td>A. Core expertise of key personnel</td>
<td>X</td>
</tr>
<tr>
<td>B. Portfolio of individual R&amp;D projects</td>
<td>X</td>
</tr>
<tr>
<td>C. Risk management &amp; real options</td>
<td>X</td>
</tr>
<tr>
<td>D. Multi-stage process depends on series of successful outcomes</td>
<td>X</td>
</tr>
<tr>
<td>E. “Make or break” quality of outcomes</td>
<td>X</td>
</tr>
</tbody>
</table>

Indeed, as shown earlier in Table 1 above, VC funds realize a major portion of their “exit” returns when established companies acquire VC-funded companies. The vested interest of mature companies in acquiring VC-funded companies explains the very existence of the VC industry, which itself accounts for the emergence of the high tech industry and its well-known participants.

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11 Figure 2 originally included in Breslin March 2015 OECD presentation.
from Intel and HP to Google and Amazon. Though there may be exceptions, these two forms of investing in R&D—*i.e.* in-house and VC-funded—cover a large portion of the privately-funded R&D conducted for commercial purposes within the US and increasingly in many countries.

*Facts and Circumstances and Functional, Asset and Risk (FAR) profiles*

It seems warranted that the new guidance would add emphasis on the importance of a thorough analysis of the *facts and circumstances* surrounding transferred intangibles. Importantly, this should include the *stage of development* of transferred rights in intangibles at the time of the transaction. At least, additional references to sections where these issues may already be well-covered in draft Chapter VI would be helpful.

Similarly, the importance of a thorough analysis of the *functional, asset and risk* (FAR) profiles of the parties to a controlled transaction (based on available facts and circumstances), while also well-covered in other areas of the guidelines, bears repeating with respect to HTVI transactions. As paragraph 1 aptly notes, there are features of HTVI that complicate the search for comparables. That said, a better understanding of the FAR profiles of the parties to any controlled transactions—and of parties to *uncontrolled* transactions that provide some arm’s length evidence—is essential. These issues will be discussed further below.

In the author’s view, inadequate analysis of these fundamental factors—for example, the stage of development of transferred intangibles and corresponding risks—largely explains the large-scale mispricing observed in major controversies in this area. In to order avoid or limit future controversies, both taxpayers and taxing authorities should give greater attention to such factors.

Referring back to Figure 2 above, in Row A we see that “Core expertise of key personnel” is essential to managing HTVI-related R&D projects that yield commercial and financial success—whether through the “internal” or “external” R&D model. These attributes can relate to multiple disciplines (scientific, financial and managerial) and take several forms.

Row B of Figure 2 also shows that an R&D program of a commercially successful company comprises a portfolio of projects. These projects and the program overall are controlled by experienced managers. Clearly, VC funds operate from the same principle—the only difference being that the R&D projects may be distributed across a portfolio of start-up companies that the VC fund helps manage.

Additionally, as shown in Row C, there is a high degree of expertise needed to control these sophisticated portfolios of R&D investments—again under both internal and external R&D scenarios. For example, in a VC fund, GPs sit on the boards of and have daily interactions with many portfolio companies. They understand the prospects for businesses and industry sectors that have yet to be developed. They also must make critical decisions regarding their portfolio
companies at each stage of their development—such as whether or not to invest additional funds in less successful start-ups and/or redirect such capital to more promising prospects.

Here again, we see the close similarity of this role with that of the R&D and financial managers in an established company. These personnel must apply similar expertise to justify investments in their projects, sponsor them through a capital budgeting process, continually assess developments, and refocus funding and resources towards those projects with the greatest expected value at appropriate points in time.

Effectively, these key activities accomplish what is described in paragraph 2, but they are not only conducted at the time of a transaction with an external party. For example, to manage and control risky investments in HTVI, one must continually:

1. Consider anticipated benefits taking into account all relevant factors;
2. Take into account the extent to which subsequent developments are foreseeable and predictable; and
3. Estimate expected values of start-ups or projects, whether or not for the purposes of fixing prices in external transactions.

This final step—estimating expected values—is necessary in order to compare the alternatives realistically available for uses of the same funds and/or resources. It is not an analysis reserved for one-time events like a transaction. Rather, it is the job of the experts that control these investments to consider a range of alternatives frequently—just as it would be among the primary functions and responsibilities of any portfolio manager.

At this juncture, one must question the extent to which an affiliate with little, if any, expertise in these areas would qualify to manage or control such investments—particularly at a long distance from relevant R&D facilities and key decision-making activities.

The probability of this is even lower when the foreign affiliate is recently created within an MNE that already has demonstrated long-standing success at developing intangibles through internal R&D in its home country or elsewhere. Of course, a full analysis of the facts and circumstances and the FAR profile of such an affiliate would be needed to determine whether it could exercise any control over or significantly affect such investments.

Meanwhile, like in-house experts in R&D-related finance, successful GPs within a VC firm must demonstrate unique financial and managerial expertise over a long history. Their track records enable them to access large amounts of risk capital from an equally elite group of financial investors, the LPs.
The probability that a low functioning foreign affiliate would be comparable to GPs within the most successful VC firms seems low to say the least. As experienced observers have noted, approximately 20 out of approximately 1000 VC firms overall account for 95 percent of total VC industry returns—with only five percent of returns arising through the remaining VC firms. Moreover, many of the top twenty have been on that list for decades running.\textsuperscript{12}

Ironically, some hypothetical scenarios appear to suggest that an MNE affiliate could quickly position itself to offer the necessary expertise, reputation and resources of GPs at these successful VC firms. This is almost analogous to waking up one day and deciding to be a centerfielder for the New York Yankees or a mid-fielder for Manchester United. There simply are not that many positions in this “field” (or “pitch” as the case may be)—never mind the aspirant’s actual skills (or lack thereof).

More recently, some commentators have posited the idea that a foreign affiliate investor in an intercompany, R&D-based CCA could be comparable to the LP investors in a VC fund. Both cases relate to a purely financial investor who need not provide any of the core skills and capabilities of GPs of VC funds discussed above.

However, the comparability gap here appears to be equally insurmountable. It is reported that “the primary types of LPs in VC funds are pension funds, university endowments, charitable foundations, and, to a lesser extent, insurance companies, wealthy families, and [fully integrated] corporations.”\textsuperscript{13} As one expert on venture capital and technology entrepreneurship notes,

> almost every sophisticated large asset pool manager uses modern portfolio theory…to determine its base asset allocation. Because of their size, pensions, endowments and charitable foundations have access to a broader set of asset classes, including hedge funds, private equity (of which VC is a component) and private investments in energy and real estate, than most individuals. Most large asset pool managers would like a 5-10% allocation to venture capital…[but] they can seldom reach their desired allocation because there aren’t enough VC firms that generate returns that justify the risk.\textsuperscript{14}

Despite the obvious gaps in comparability in terms of functions, assets and risks, in the author’s view, the notion that a foreign affiliate formed as a “cash box” could realize VC-type returns is completely overrun empirically.


\textsuperscript{13} Ibid.

\textsuperscript{14} Ibid.
For example, Table 1 reflects that in publicly reported disputes, the foreign affiliates are “batting 1000” (which in American baseball-speak translates to a 100 percent success rate). That is, their R&D investments in intangible development projects are consistently yielding 10x returns (see Row E), while even the best among VCs (and their LP investors) hope for a 25 percent success rate (in Row D).\(^\text{15}\)

However, public information about the facts and circumstances in such cases indicate that the rights to invest in and develop core, later stage technology were transferred to the foreign affiliate at an early stage price.\(^\text{16}\) The effect of this is to reward later stage investors for risks they did not assume on investments they did not (and were not able) to manage—at the expense of those that did assume such risks and manage such assets.

Thus, these hypotheticals attempt to turn Table 2 on its head and provide late stage investors with early stage returns. Table 2 empirically disproves the proposition that such results would occur at arm’s length.

Sincerely,

Patrick Breslin
WASHINGTON, DC
June 18, 2015

\(^{15}\) For a detailed discussion of VC partner compensation to active “general partners” versus purely financial “limited partner” investors, see Breslin, “An Early-Stage Investor Analogy: How Related-Party Transfers of Intangibles Contribute to Base Erosion and Profit Shifting.” Tax Management Transfer Pricing Report 22, no. 10 (2013).

June 18, 2015

Organisation for Economic Cooperation and Development
Centre for Tax Policy and Administration
Attn. Andrew Hickman, Head of Transfer Pricing Unit
2, Rue André Pascal
75775 Paris, France

Re: Comments on Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles

Dear Mr. Hickman:

The National Foreign Trade Council (the “NFTC”) is pleased to provide written comments on the Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles, published June 4, 2015 (the “HTVI Discussion Draft”).

The NFTC, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD in establishing international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations, and we appreciate the opportunity to comment on this important project. A list of the companies comprising the NFTC’s Board of Directors is attached as an Appendix.

The NFTC appreciates the opportunity to provide comments to the OECD on these important issues. In general, although we are sympathetic to the administrative concerns around information asymmetry in the context of HTVI, the use of hindsight in evaluating ex ante transfer pricing arrangements is inconsistent with the arm’s length principle and therefore should be limited to narrowly circumscribed cases. The use of hindsight in this context is a special measure that requires very careful consideration to ensure that it is applied only in appropriate circumstances. We urge the OECD to allow for appropriate time and stakeholder input before incorporating this extraordinary guidance into the Transfer Pricing Guidelines. The issues here are at least as difficult and significant as the work involving profit splits, which has been put on a more reasonable timeline. We also urge the OECD to provide more detailed guidance with regard to the administration of these rules. In particular, given the extraordinary
nature of these rules, we recommend that they be applied only in the case of transfers of intangibles that occur after the date that the rules are incorporated into the Transfer Pricing Guidelines.

We provide below more detailed comments.

Paragraph 5 – Price Adjustment Clause and Subsequent Developments

Paragraph 5 of the HTVI Discussion Draft, the language of which is included in the current Transfer Pricing Guidelines, asserts that there are circumstances in which parties at arm’s length would have insisted on price adjustment clauses in contracts, or would have insisted on the prospective renegotiation of an ongoing arrangement due to subsequent developments. The NFTC recommends that the language in paragraph 5 be eliminated or substantially redrafted given the new tools provided by the HTVI Discussion Draft to tax administrators. In the context of the current guidelines, the language of paragraph 5 provides a mechanism for tax authorities to take ex post information into account in evaluating the arm’s length nature of ex ante pricing arrangements. Parties at arm’s length deal with uncertainties in many different ways, however, and it is not possible or advisable to prescribe circumstances in which parties would have always included price adjustment clauses or insisted on renegotiations. Accordingly, assertions that parties at arm’s length would have dealt with uncertainty in any one particular way, to the exclusion of other ways, are inconsistent with the arm’s length principle.

Moreover, the NFTC believes that the approach of the new guidance in the HTVI draft beginning at paragraph 6, which is based on information asymmetries rather than observed arm’s length behavior and which provides new tools to tax administrators to use ex post information in narrow circumstances, is more conceptually sound than the approach in paragraph 5. The guidance is more conceptually sound because it does not rely on assertions about arm’s length behavior. Accordingly, we recommend that the guidance from paragraph 6 forward should be the exclusive mechanism under which tax authorities are permitted to take ex post information into account in evaluating the arm’s length nature of ex ante pricing arrangements, and therefore that the language in paragraph 5 be eliminated or substantially redrafted.

Paragraph 9 – Corresponding Adjustments

Paragraph 9 of the HTVI Discussion Draft provides an overview of new section D.3.1, stating that this section “outlines approaches which tax administrations may adopt in dealing with … HTVI.” (emphasis added). The NFTC recommends that this language be clarified to provide an obligation on countries to consider these approaches in evaluating a request for a
corresponding adjustment under a treaty obligation similar to that of Article 9.2 of the OECD Model Tax Convention.

An important role of the Transfer Pricing Guidelines is to govern the resolution of transfer pricing cases in mutual agreement proceedings. See OECD Transfer Pricing Guidelines, Preface at ¶ 17. Countries ascribing to the Transfer Pricing Guidelines should be obligated to consider the Guidelines, including the new guidance on HTVI, in considering requests for corresponding adjustments and in resolving mutual agreement cases. The “may adopt” language from paragraph 9 calls into question whether a country can choose, for purposes of responding to a request for a corresponding adjustment, to ignore the new HTVI guidance. This could lead to double taxation contrary to the purposes of the Transfer Pricing Guidelines and the OECD Model Tax Convention.

Accordingly, the NFTC recommends that the language of the HTVI Discussion Draft be clarified to provide an obligation on countries to consider the new guidance in evaluating requests for a corresponding adjustment where the primary adjustment is based on the new guidance.

Definition of HTVI

Paragraph 9 of the HTVI Discussion Draft defines HTVI as a transferred intangible where (1) no sufficiently reliable comparables exist, and (2) there is a lack of reliable projections for future cash flows, or the assumptions used in valuing the intangible are highly uncertain. In addition, paragraph 10 lists several features that HTVI “may exhibit.” The definition is critical because the new guidance in the HTVI Discussion Draft applies only to transfers of HTVI. The NFTC recommends limiting the definition of HTVI to intangibles that are likely to present the type of information asymmetries that justify the consideration of ex post information and that present a material risk of BEPS.

In addition, an implicit assumption in the paragraph 9 definition is that the MNE used either a CUP method that referenced transfers of comparable intangibles, or an income method that referenced projected cash flows. The NFTC recommends that consideration be given to the application of the new guidance in cases where arrangements are priced with reference to other methods, such as the transactional net margin method and profit splits, that reference neither transfers of comparable intangibles nor projections of future cash flows.

With respect to profit splits in particular, the Guidance on Intangibles published in September of 2014 states that the profit split method may be useful in pricing transfers of intangibles, particularly where it is not possible to identify a reliable CUP. See paragraphs 6.142, 6.145, and 6.199 of the Guidance on Transfer Pricing Aspects of Intangibles (Action 8: 2014 Deliverable).
Similarly, the Discussion Draft on Profit Splits published December 16, 2014, states that a profit split may be reliable for pricing HTVI. See paragraphs 44 to 49 of the Discussion Draft on Profit Splits. Paragraph 45, in particular, says that a profit split might be a reliable way to address significant differences between ex ante and ex post results and that a profit split “may provide an appropriate way to deal with unanticipated events where strategic risks are effectively shared between associated enterprises.” (emphasis added).

The previous work on BEPS has favored the use of profit splits in the context of pricing transfers of intangibles. It is not clear how such proposed guidance on the use of profit splits to reliably evaluate pricing arrangements in the context of uncertainty interacts with the new guidance in the HTVI Discussion Draft. Under a properly constructed profit split, the actual profits, whether anticipated or not, are split in accordance with each party’s relative share of non-routine contributions. Therefore, the NFTC recommends that, where a profit split is appropriately applied, the HTVI guidance would not apply.

Additional Exceptions

Paragraph 14 of the HTVI Discussion Draft allows the taxpayer to rebut the use of ex post information if the taxpayer (1) provides the full details of its ex ante projections, including how risks were accounted for and how comprehensively it considered reasonably foreseeable events; and (2) provides satisfactory evidence that any significant difference between the ex ante projections and ex post outcome were due to unforeseeable or extraordinary developments or events that could not have been anticipated at the time of the transaction. The box following paragraph 15 invites comments on, among other items, “whether any additional exemptions should be added to the exemption contained in paragraph 14.”

The NFTC recommends that consideration be given to clarifying that the categorization of an intangible as HTVI creates an evidentiary presumption that tax administrations may use ex post information, but that such presumption may be rebutted by the presentation of information confirming the reliability of the ex ante valuation or other method used to price the transaction. Paragraph 12 of the HTVI Discussion Draft provides that “[w]here the tax administration is able to confirm the reliability of the information on which ex ante pricing has been based . . . then adjustments based on ex post profit levels should not be made.” While that language is welcome, the relationship between paragraph 12 and paragraph 14 is not clear. For this reason, the NFTC recommends supplemental language in paragraph 14 permitting taxpayers to rebut the use of ex post information by presenting information confirming the reliability of the ex ante valuation or other method used to price the transaction. Under such a framework, the “extraordinary developments” exception is merely an example of the type of information that a taxpayer may present to demonstrate the reliability of the ex ante pricing.
The NFTC also recommends two other examples that would apply in addition to the “extraordinary developments” example. First, the NFTC recommends that taxpayers be permitted to rebut the presumption that ex post information may be used by demonstrating that the differences between the financial projections and the actual outcomes were due to the occurrence of unlikely, but foreseeable, events that were adequately considered in the initial valuation. This would be particularly appropriate where the taxpayer’s ex ante projections incorporate more than one potential outcome, each of which are probability weighted. In such a case, the ex ante pricing arrangement should be evaluated based on the extent to which the probability weighting was reasonable at the time of the transfer. For example, financial projections related to the potential development and commercialization of a pharmaceutical compound might incorporate different outcomes based on the timing and grant of regulatory approvals. Ironically, the absence of such guidance might lead taxpayers to base their ex ante pricing on one potential outcome rather than to incorporate all likely outcomes, leading to a less reliable result.

Second, the NFTC also recommends that taxpayers be permitted to rebut the presumption that ex post information may be used by demonstrating that the ex ante projections did not differ significantly from actual results for a certain period of time following the transfer. For instance, if the actual results for the first three or five years following the transfer (or the first three or five years following the generation of significant revenue from the transferred intangible) did not differ significantly from the taxpayer’s ex ante projections on a cumulative basis, then ex post information could not be used to evaluate the arrangement in future years. This would be the case regardless of the method used by the taxpayer to price the transaction.

Finally, the NFTC recommends that the HTVI guidance state more explicitly that the consideration of ex post information will be used only in cases of material differences between ex ante projections and actual results. At a minimum, we recommend that paragraph 13 be re-worded to state that “[T]he approach should be applied only in situations where the difference between ex post outcomes and ex ante projections is significant . . . .” We further recommend that a second sentence be provided to introduce the exception in paragraph 14.

Sincerely,

Catherine G. Schultz
Vice President for Tax Policy
National Foreign Trade Council
cschultz@nftc.org
202-887-0278 ext. 2023
Appendix to NFTC Comments on BEPS Action Items 8: Hard-to-Value Intangibles

NFTC Board Member Companies:

- McKenna Long & Aldridge LLP
- ABB Incorporated
- AbbVie Pharmaceuticals
- Applied Materials
- Baxter International Inc.
- British American Tobacco
- Caterpillar Incorporated
- Chevron Corporation
- Chrysler Corporation
- CIGNA International
- Cisco Systems
- Coca-Cola Company
- ConocoPhillips, Inc.
- Deloitte & Touche
- DHL North America
- eBay, Inc.
- E.I., du Pont de Nemours & Co.
- Ernst & Young
- ExxonMobil Corporation
- Fluor Corporation
- Ford Motor Company
- General Electric Company
- Google, Inc.
- Halliburton Company
- Hanesbrands Inc.
- Hercules Group
- Hewlett-Packard Company
- Johnson & Johnson

- JPMorgan Chase & Co.
- KPMG LLP
- Mars Incorporated
- Mayer Brown LLP
- McCormick & Company, Inc.
- Microsoft Corporation
- Occidental Petroleum
- Oracle Corporation
- Pernod Ricard USA
- Pfizer International Inc.
- PricewaterhouseCoopers LLP
- Procter & Gamble
- Prudential Insurance
- Ridgewood Group International, Ltd.
- Siemens Corporation
- Sullivan & Worcester LLP
- TE Connectivity
- Toyota
- Tyco International
- United Parcel Service, Inc.
- United Technologies
- Visa, Inc.
- Walmart Stores, Inc.
Dear Mr Hickman,

Comments on the Public Discussion Draft on Arm’s Length Pricing of Intangibles when Valuation is Highly Uncertain at the Time of the Transaction and Special Considerations for Hard-to-Value Intangibles

Thank you for the opportunity to provide comments on the Public Discussion Draft on BEPS Action 8: *Hard-to-value intangibles* (the “Discussion Draft”) dated June 4, 2015.

PricewaterhouseCoopers LLP (“PwC”), on behalf of its international network of Member Firms, welcomes the consideration given by the OECD to develop an approach to hard-to-value intangibles and the proposed revisions to the existing guidance of Chapter VI of the OECD Transfer Pricing Guidelines.

As a global professional services business with a network of firms throughout the world, we have worked with tax authorities globally over many years regarding the development of transfer pricing rules that affect multinational entities (“MNEs”) in their cross-border transactions. As a result, we have extensive experience with a wide range of issues relevant to both taxpayers and tax authorities.

In our previous submissions to the OECD in connection with BEPS Actions 8, 9 and 10, we expressed that any special measure considered by the OECD should be consistent with the arm’s length principle. Today, differing guidance exists providing direction on how transactions should be considered within the sanctity of the arm’s length principle. Any additional special measure that goes beyond the arm’s length principle is likely to lead to significant uncertainty and unpredictability. In that respect, we are pleased to see that the OECD has removed from the Discussion Draft some of the initial proposals it envisaged for dealing with “thick capitalisation”, “minimal functional entity” and “capital-rich asset owning companies”.

Although the Discussion Draft attempts to set boundaries around situations where it may be appropriate for tax administrations to use *ex post* information, we believe that the Discussion Draft depends too heavily on subjective terminology to set those boundaries. In particular, the language used around the provision of “satisfactory evidence”, “significant differences” between expectations and outcomes and whether outcomes were “unforeseeable”, “extraordinary” or could have been “anticipated” paves the way for tax authorities to claim the right to use *ex post* information in almost
any situation dealing with intangibles that fall into the overly broad defined category of “hard-to-
value” intangibles.

In the following, we set forth an overview of some concerns we wish the OECD to address so as to
preserve some fundamental tenets of transfer pricing and the arm’s length principle.

**Detailed Comments:**

1. There are many reasons why OECD member countries and other countries have adopted the arm’s
length principle. One of the major reasons is that the arm’s length principle provides broad tax
parity of tax treatment for members of MNE groups and independent enterprises. Because the
arm’s length principle puts associated and independent enterprises on a more equal footing for tax
purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort
the relative competitive positions of either entity. By removing tax considerations from economic
decisions, the arm’s length principle promotes the growth of international trade and investment.

We are concerned that the Discussion Draft – and paragraph 5 in particular – deviates
significantly from the arm’s length standard as it may support the ability of tax authorities to re-
characterise almost any transfer of intangibles based on pure speculation about alternative,
hypothetical pricing arrangements that could possibly have been entered into by independent
enterprises. By suggesting that tax administrations should be permitted to determine pricing on
the basis of the fact that independent enterprises would have insisted on a price adjustment clause
or would have considered subsequent fundamental developments, paragraph 5 – if accepted in
final form – is likely to lead to significant uncertainty and unpredictability regarding the pricing of
intangibles. PwC finds it particularly concerning that the OECD does not sufficiently consider that
MNE groups, as would independent enterprises, have specific business insights, expertise, know-
how and information all of which are important elements when determining the arm’s length price
at the time of a transaction. Conversely the OECD seems to have overlooked the fact that tax
authorities might lack such know-how, information or expertise. The proposed measure seems to
be purely designed to enable tax authorities to re-characterise the transaction based on a mere ex
post assessment – even in the continuous absence of specific business insights, expertise and
know-how – as to whether potential future developments where appropriately weighted by the
taxpayer at the time of the transaction. This is further amplified by the examples given by the
OECD in paragraph 15 of the Discussion Draft – i.e. the unexpected bankruptcy of a competitor or
a natural disaster - which seem to be setting an inappropriate benchmark of what would constitute
“unforeseeable” events at the time of the transaction.

PwC recommends that the proposed revisions to the OECD Guidelines focus on providing
objective advice to MNEs rather than installing an overly broad re-characterisation measure. The
current Discussion Draft includes too many subjective terms that may be pejorative and, therefore,
interpreted differently by rational decision makers. More time and consideration needs to be
devoted to refining the Discussion Draft as the measure proposed could fundamentally change the
existing transfer pricing rules implemented by many countries and is likely to lead to increased
double taxation globally. In that respect, PwC is of the opinion that such additional consideration
needs to be provided to the entirety of the measures proposed in the Discussion Draft and not only
to the “additional points” on which the OECD requested to receive input. Moreover, in doing so,
PwC recommends the OECD to give appropriate consideration to the time limits within which tax
administrations would be allowed to invoke the application of the special measure. The more time
that has elapsed between the time of the transaction and the auditing thereof by tax
administrations, the more likely it is that the burden of proof imposed on taxpayers to
demonstrate that they should have considered subsequent developments will become disproportionate to the powers allotted to tax administrations and the precious balance sought by the OECD between the use of ex post information and hindsight is distorted.

2. Whilst the Discussion Draft notes that the proposals made should be distinguished from the situation in which hindsight is used inappropriately by not taking into consideration whether information could or should have been reasonably known and considered by the associated enterprises at the time of the transfer, PwC is of the opinion that the Discussion Draft fails to consider the conduct of the parties subsequent to the transfer of the intangible. Whereas differences between ex ante and ex post profit levels might be related to developments or events arising after the transaction, PwC recommends that the OECD amend the Discussion Draft so as to ensure that tax authorities equally recognize the role of parties in developing, enhancing, maintaining, protecting and exploiting the intangible when assessing the differences in ex ante and ex post profit levels and whether the differences can be tied to the functions performed, risks assumed and assets deployed by the parties to the transaction. Consideration of the foregoing would better fit within the full scope of proposals made by the OECD in relation to its work on the transfer pricing aspects of intangibles as part of Action Plan item 8.

3. PwC believes that the combination of the wording proposed by the OECD in paragraphs 9 and 10 does not sufficiently limit the power of tax authorities to invoke the possibility to use ex post information. PwC believes that paragraph 9 already concludes on the fact that for any of the intangibles falling in the “hard-to-value” intangibles definition, (i) no sufficiently reliable comparables exist; (ii) there is a lack of reliable future cashflows; or (iii) income expected to be derived from the transferred intangible or the assumptions used in valuing the intangible are highly uncertain. Moreover, PwC is of the opinion that the definition of hard-to-value intangibles as proposed by the Discussion Draft is overly broad and, hence, almost any category of intangibles could be seen by tax authorities as falling within this definition. Therefore, the current Discussion Draft does not seem to impose an obligation on tax authorities to attempt to reach a conclusion consistent with the arm’s length principle that is satisfactory to all parties involved taking into account the facts and circumstances of the case and the mix of evidence available as proposed by paragraph 2.11 of the OECD Guidelines.

4. The wording of paragraph 9 of the Discussion Draft seems to indicate tax administrations may or may not choose to adopt the measure proposed by the Discussion Draft. Hence, if the Discussion Draft would be finalised in its current form, MNEs are likely to be confronted with situations whereby a tax administration of one of the relevant countries to a transaction has adopted the measure proposed by the Discussion Draft whereas the tax administration of the other country has not. In order to avoid instances of double taxation - which might arise as a result of a tax administration of the country that has not adopted the measure proposed by the Discussion Draft claiming that the adopted measure is inconsistent with the arm’s length principle as a result of which the case would not be eligible for resolution under the Mutual Agreement Procedure – we recommend the OECD to (1) give further consideration to the measure to make sure it meets the arm’s length standard and (2) suggest agreement by tax administrations (even if they did not adopt the proposed measure themselves) to consider the approach adopted by a tax administration of another country so as to guarantee eligibility for MAP to resolve double taxation. This could for instance be included in the scope of the OECD’s work on Action Plan item 14.

5. Although PwC applauds the Discussion Draft’s attempt to set boundaries around the situations where it would or would not be appropriate for tax administrations to use ex post information, PwC is of the opinion that the boundaries proposed in the Discussion Draft depend upon
subjective terminology such as “providing satisfactory evidence” about “significant differences” between expectations and outcomes and whether outcomes where “unforeseeable, extraordinary or could have been anticipated”. In this respect, PwC recommends the OECD consider introducing more tangible exceptions to the use of ex post information by tax administrations. Such exceptions could take the form of a safe harbour deviation between the ex ante and ex post results (e.g. in case the ex post results are within an 80% - 120% bandwidth of ex ante results) or a time limit to the period in which tax administrations can use ex post information (e.g. in case ex post results of the first 3 or 5 years following the transaction fall within an acceptable bandwidth of ex ante results, tax administrations should not be allowed to use ex post information beyond that 3 or 5 year period).

PwC is of the opinion that the Discussion Draft in its current form provides too much leeway to tax authorities to claim that the evidence provided by a taxpayer is not satisfactory and, hence, if the Discussion Draft would be finalised in its current form it is very likely that tax authorities will claim the right to use ex post information in almost any situation where reliable comparables are not available to support the pricing of an intangible that ultimately turns out to be successful in the marketplace. In conclusion, with regard to the special measure proposed for hard-to-value intangibles, PwC believes that the currently proposed measure seems to be underdeveloped at this stage. We would, therefore, recommend that the final measure be developed so that it can provide objective guidance to MNEs and tax administrations, and ensure that it remains consistent with the arm’s length principle and also with the OECD’s remaining output on the relevant items under BEPS Actions 8, 9 and 10. Importantly, care must be taken so the final Guidelines do not, in effect, pave the way for tax authorities to claim the right to use ex post information in almost any situation dealing with intangibles that fall into the overly broad defined category of “hard-to-value” intangibles.
***

On behalf of the global network of PwC Member Firms, with the contribution of our colleagues David Ernick, Patrick Boone and Jonas Van de Gucht, we respectfully submit our response to the Public Discussion Draft on BEPS Action 8: Hard-to-Value intangibles. For any clarification of this response, please contact the undersigned or any of the contacts below.

Yours faithfully,

Isabel Verlinden  
Partner  
PricewaterhouseCoopers, Brussels

Adam M. Katz  
Partner  
PricewaterhouseCoopers LLP, New York

cc Stef van Weeghel, Global Tax Policy Leader

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To Mr. Andrew Hickman - Head of Transfer Pricing Unit, Centre for Tax Policy and Administration.

Email: TransferPricing@oecd.org

Dear Mr. Hickman, dear Andrew

Please find attached the comments of Quantera Global in respect of the Discussion Draft on BEPS action 8: Hard To Value Intangibles.

Kind regards,

Richard Slimmen
Managing Director
M: + 31 6 50 88 94 37
E: r.slimmen@quanteraglobal.com
Comments on
the Discussion Draft on BEPS action 8:
Hard To Value Intangibles

By

Quantera Global
Quantera Global welcomes the opportunity to provide its comments to BEPS Action 8: Hard To Value Intangibles (“Discussion Draft”).

We highly appreciate the work that the OECD has done so far and appreciate the difficulty of the matter. Please find below our comments. We hope they may contribute to a better understanding of the issues and to an optimal guidance.

We look forward to discussing these matters in more detail during the public consultation in July 2015.

General observations

The Discussion Draft provides for a reasonable approach on how to deal with Hard To Value Intangibles (”HTVI”) from a conceptual perspective. In case of a HTVI the actual ex post financial outcomes are used as presumptive evidence to verify the reliability of the projections used in establishing the transfer price. When ex post outcomes are significantly different from the ex ante projections tax administrations would be allowed to use the ex post evidence to determine arm’s length pricing, including the imputation of price adjustment clauses or other appropriate measures. Taxpayers may rebut this evidence by demonstrating they made a proper contemporaneous effort to use best projections and anticipate on reasonably foreseeable events that might impact pricing.

We appreciate the reasoning behind the approach and feel it could be in balance with the interests of both tax administrations and tax payers. We do note however that little practical guidance is provided yet on how to implement the approach. As HTVI may be considered to be one of the most pressing issues in terms of interests at stake and complexity of disputes, there is a strong need for practical guidance on how to resolve discussions involving HTVI. Next to practical guidance it is essential that all stakeholders, both tax payers and tax administrations, have a common understanding of what the approach entails. This requires wording that is clear and consistent and leaves as little room as possible for different interpretations.

We notice that the wording used in the Discussion Draft is not always consistent which might be confusing and cause unnecessary discussions. Sometimes reference is made to ‘financial outcome’ while elsewhere reference is made to ‘profit levels’ or just ‘information’. It would be good if consistent wording would be used. We assume it is intended to compare ex ante information used to calculate the price for a HTVI transfer with the same ex post information. Depending on the chosen valuation/calculation method this may relate to cash flow, revenue, units sold, etc. We suggest to align the wording of the Discussion Draft in this respect and to avoid mere focus on profitability when comparing ex ante with ex post information. Bear in mind that the aim is to get a grip on the valuation of the HTVI not on the profitability of a group entity, although they may overlap to some extent.

The Discussion Draft rightly indicates that any evaluation should focus on the time of the transaction and that the use of hindsight is not allowed. The use of ex post information is only allowed to assist in evaluating the proper pricing at the time of the transaction. However the current wording in paragraph 7 might suggest that there would be circumstances in which the use of hindsight could be considered appropriate? We suggest to delete the word ‘inappropriately’ to avoid any misunderstandings.
We welcome the explicit wording that clarifies that tax administrations should not only rely on the ex post financial outcomes to determine whether the ex ante pricing was based on sufficiently reliable information. It would be helpful though if some examples could be added to illustrate when this might be the case.

Definition of HTVI

We feel the current definition includes an element that should not be included. The definition aims to clarify what assets should qualify as HTVI. It should therefore focus on the specifics of the asset and not on the behaviour of the asset owner. In this respect we feel the reference to a lack of reliable projections might better be deleted from the definition. A potential reason for a lack of reliable projections may be the fact that the assumptions used in valuing the intangible are highly uncertain. In so far the lack of reliable projections seem to have an overlap with the highly uncertain assumptions. The definition could in our view be limited to a reference to a lack of sufficiently reliable comparables and reference to the highly uncertain assumptions. Whether a taxpayer has or has not made reliable projections should not impact the answer to the question if there is a HTVI. It will however become relevant when considering the exemption as described in paragraph 14.

Options to deal with uncertainty

The Discussion Draft indicates several options that might be considered by independent enterprises to deal with a certain level of uncertainty. Although the different options are clear there is little guidance when to expect/apply which option. Some options (renegotiate, use short term contracts) do not involve contractual clauses to adjust pricing whereas an adjustment clause will. When an adjustment clause would be applied there is no guidance as to what that clause should look like.

The Discussion Draft also indicates that tax administrations often lack specialised knowledge and expertise to be able to verify or identify what developments are relevant for the pricing of a transaction involving intangibles. This might easily include knowledge about which option to use to best manage the level of uncertainty. Still the Discussion Draft does not provide for any guidance in this respect, leaving it up to tax administrations to do something they might not be sufficiently qualified for. In fact the lack of specialised knowledge and expertise is presented as the main driver for the development of the approach laid down in the Discussion Draft. If the effect of the new approach would be limited to having the same discussions as before between tax payers and tax administrations with only a reallocation of the burden of proof to tax payers, it would be imbalanced and no more than a next anti-avoidance/anti-abuse measure. We do like to believe however that the intention of the Discussion Draft is to provide a balanced approach how to deal with this complex issue.

The lack of specific guidance in respect of what kind of option to apply in what circumstances and how an adjustment clause should work out might result in arbitrary adjustments which will result in complex disputes. We therefore strongly suggest to provide further guidance on these matters. From a practical perspective all stakeholders might benefit from a consensus to a well-defined default adjustment clause to be imputed in
case an adjustment would be required based on ex post outcomes. Although this might include some level of artificial uniformity, the benefit of clear and practical guidance would certainly outweigh.

It would also be welcomed if some guidance would be provided on how to deal with situations where a taxpayer has applied one of the options but still the ex post outcome would significantly differ from the ex ante projections. Would a tax administration be allowed to apply a different option to account for the uncertainty of the transfer or would it be restricted to a modification of the option applied by the tax payer?

Ex ante versus ex post

Although the general concept seems straight forward, just compare projections with actuals, we feel further clarification is needed on its practical application. It is for example not clear how to deal with multiple year data. Any projections involving transfer of intangibles will likely involve multiple years. The Discussion Draft does not provide any guidance on how to apply an ex post evaluation in such a case. Would it be allowed for tax administrations to make adjustments already if the first year after the transfer of the intangible the ex post information in respect of that year would differ significantly from the ex ante projections? If projections would cover a five year period it might very well be that over such longer period the initial difference will be compensated in later years resulting in an overall situation that might not deviate significantly from the result using the ex ante projections. Would tax administrations need to wait for the relevant period to have passed before an adjustment based on the presumptive evidence would be acceptable? Given the fact that projections by nature will be inaccurate to some extent, we would suggest to apply the suggested approach (apply ex post information as presumptive evidence) not before the relevant period used in the ex ante projections would have passed. If this would involve too long a period we would suggest to limit it to e.g. five years.

The Discussion Draft indicates that the suggested approach should only be applied in case of significant differences between ex ante projections and ex post outcomes. There is however no clear guidance on what would be considered ‘significant’. We believe the limitation of the suggested approach to significant differences is appropriate but we feel further guidance on what would constitute such difference is required. Without clear guidance it is likely that tax administrations will interpret in different ways, resulting in inconsistencies and future disputes. We therefore strongly suggest to clarify the term ‘significant’ and provide a clear percentage. In order to be significant we would propose a difference to be at least 30% of the ex ante projections.

The Discussion Draft is not clear on what information should be considered when comparing ex ante projections with ex post outcomes. It seems to be intended to compare the end results, being the transfer price applied ex ante and the transfer price using the ex post figures but applying the same calculation methodology as used to establish the ex ante transfer price. The end result of a calculation, the price of the HTVI, may however be depending on multiple variables that have been estimated. Every single ex post variable might on its own differ significantly from the ex ante variable. But a significant difference in individual variables may not automatically result in a significant difference of the end result. We would welcome some clarification that ex ante/ex post
evaluation should focus on the end result, the price of the HTVI, and not on individual variables used in a calculation to establish this price.

Burden of proof

It will be essential in practice to provide clear guidance on how to manage any disputes arising from the different interpretations of arbitrary terms like ‘reliable’, ‘sufficiently predictable’ and ‘unforeseeable’.

The approach suggested in the Discussion Draft effectively means that in case of a transfer of a HTVI with significant differences between ex ante projections and ex post outcomes the burden of proof is put on the taxpayer to convince the tax administration that they should not base an adjustment on the ex post outcome. If adjustments are made and taxpayer initiates a MAP, a question may be whether such allocation of the burden of proof would also apply to the other competent authority. Usually in a MAP the party making the adjustment is expected to convince the other party. This might conflict with the approach in the Discussion Draft. As a result a MAP might become even more of a challenge. We would therefore welcome further guidance on how the approach described in the Discussion Draft would/should impact MAP procedures. It should not be the case that applying the suggested approach would result in taxpayer being confronted with higher risk of double taxation.

Paragraph 14 addresses the opportunity of a taxpayer to avoid the application of the suggested approach by providing certain information. Part of the information relates to the efforts made by the taxpayer to establish proper projections. We note that this effort would not need approval by the tax administration. However we would expect the taxpayer to have to provide evidence of sufficiently detailed information that could be considered to be proper substantiation of the ex ante projections. The other part of the information relates to unforeseeable or extraordinary developments or events that could not have been anticipated. We appreciate the conceptual perspective but would welcome some further clarification what would be considered unforeseeable or extraordinary. Would for example a unexpected increase of sales volumes (outside a regular steady growth as achieved in past years) qualify? Or would it be necessary to identify the exact reasons for such increase? Sometimes markets may just develop in a certain way without a specific cause that can be identified. The need to analyse and provide evidence about the difference between projections and actual outcome does put a material compliance burden on the taxpayer. Some examples might be helpful.
16 June 2015

Dear Mr Hickman

BEPS Action 8: Discussion Draft on Hard-to-value Intangibles

We are writing in response to the OECD’s request for comments in relation to the Discussion Draft on Hard-to-value Intangibles (“HTVIs”) released on 4 June 2015.

RELX Group is a world leading provider of professional information solutions. We operate across several professional market segments through five business divisions comprising of Elsevier, LexisNexis Legal and Professional, LexisNexis Risk Solutions, Reed Exhibitions and Reed Business Information. RELX Group operates in more than 30 countries and employs approximately 28,500 people worldwide.

We set out below our representations on the discussion draft. Our representations are focussed on the key issues for the RELX Group in relation to the discussion draft as follows:

1. Businesses need certainty in relation to their transactions. One of the key principles proposed in the discussion draft is the use of ex post evidence to challenge the pricing of transactions, specifically in relation to HTVIs. We consider that the use of ex post information would create a high level of uncertainty for multinational groups as this increases the ability of the tax administrations to challenge pricing, in some cases many years after the transaction has taken place. We do not consider the use of ex post information to be a reasonable approach to re-price transactions

2. Neither related nor unrelated parties have the benefit of hindsight when entering into business transactions. Businesses therefore typically use the best information available to them at the time when entering into commercial arrangements. As long as that information was considered to provide a reasonable basis for valuing the transaction at the time the transaction took place, we consider there should be no reason to adjust the transaction price based on ex post information.

3. Paragraph 12 states that adjustments based on ex post profit levels should not be made where “the tax administration is able to confirm the reliability of the information on which ex ante pricing has been based”. We think that this wording is too subjective with regards to what evidence tax administrations may require in order to “confirm the reliability” of the information used. It places the onus on the taxpayer to demonstrate this by asking, for example, for the taxpayer to provide satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or
extraordinary developments or events occurring after the determination of the price. Instead, we consider that the onus should be on the tax administration to demonstrate that it was not considered reasonable at the time of the transaction for the taxpayer to rely on the information used to value the transaction. Therefore the tax administration should only have the option of using ex post pricing to adjust a transaction where it can demonstrate that the information used by the taxpayer for the ex ante pricing was clearly unreliable at the time the original transaction took place.

4. We consider that APAs could potentially play a role in providing greater certainty for taxpayers regarding HTVIs. By using an APA in such cases the taxpayer and tax administration could agree how to deal with HTVIs up front and even agree on what evidence is required to avoid a later review based on subsequent information. However, APAs can take a substantial amount of time to agree and an increase in the volume of applications could put a heavier burden on APA teams within tax administrations, which could further extend the time taken to reach an agreement.

5. Paragraph 13 states that the approach should only be applied where “the difference between ex post outcomes and ex ante projections is significant”. We consider that further guidance should be provided as to what constitutes a “significant difference”. This could be particularly relevant in situations where one party to the transaction would consider the difference to be significant but another party does not.

We would like to thank you for providing us with the opportunity to comment on the discussion draft and look forward to being included in the discussion process.

Yours faithfully

Paul Morton
Catherine Harlow
Paul Hewitt
June 18, 2015

**VIA E-MAIL**

Andrew Hickman  
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**Re:** Comments on Public Discussion Draft—BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES

Dear Mr. Hickman,

The Silicon Valley Tax Directors Group (“**SVTDG**”) hereby submits these comments on the above-referenced *Public Discussion Draft*, issued on June 4, 2015. SVTDG members are listed in the Appendix.

Sincerely,

Jeffrey K. Bergmann

Co-Chair, Silicon Valley Tax Director’s Group
I. INTRODUCTION AND SUMMARY

We thank Working Party No. 6 for preparing the Public Discussion Draft—BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES (“Action 8 HTVI PDD”) and for asking interested parties to give written comments. In this letter we comment on six aspects of the Action 8 HTVI PDD: (i) we explain that Article 9, ¶ 1 of the OECD Model Tax Convention would have to be changed to properly authorize the sorts of adjustments contemplated by the HTVI approach; (ii) we recommend that adjustments of the kind contemplated by the HTVI approach should only be made for associated-enterprise transactions entered into after an approach is finalized; (iii) we recommend changes be made to the language to improve certainty associated with application of the HTVI approach; (iv) we recommend changes be made to the language to improve certainty associated with the exemption from application of the HTVI approach; (v) we recommend adding a time-based exemption from application of the HTVI approach; and (vi) we comment on some economic assertions underlying statements in the Action 8 HTVI PDD.

II. DISCUSSION OF SPECIFIC CONCERNS

A. Authority for making adjustments of the kind proposed in Action 8 HTVI PDD would require a change to Article 9, ¶ 1 of the OECD MTC

The Action 8 HTVI PDD states that in a transaction among associated enterprises involving HTVI—

[i]n evaluating the ex ante pricing arrangements, the tax administration is entitled to use the ex post evidence about financial outcomes to inform the determination of the arm’s length pricing arrangements, including any contingent pricing arrangements, that would have been made between independent enterprises at the time of the transaction.¹

The HTVI approach described in the Action 8 HTVI PDD would, in the case of such a transaction, permit a tax administration to recharacterize the payment terms of the transaction—i.e., both the form and the amount of the payment—based on ex post information. This recharacterization is contrary to the arm’s length principle (“ALP”).

Paragraph 1.6 of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (the “TPG”) provides that the authoritative statement of the ALP is found in Article 9 of the OECD MTC:

[Where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly. [Emphasis added]

¹ Action 8 HTVI PDD, ¶ 12.
The ALP grounds application of the TPG, including treatment of transactions among associated enterprises involving hard-to-value intangibles. If any difference referenced in the opening clause exists, an allocation of profits among the associated enterprises is allowed by the second part of the sentence. In the phrase “those which would be made between independent enterprises,” “those” refers to conditions that would be made between independent enterprises. So the opening clause asks whether there’s a difference between (1) certain conditions that exist (“are made or imposed”) between associated enterprises; and (2) hypothetical conditions (“those which would be made”) between independent enterprises.

The existing conditions among associated enterprises must relate specifically to (actual) “commercial or financial relations” between such enterprises. The hypothetical nature of the conditions must relate to supposed (i.e., assumed) behavior of independent enterprises. Making the comparison between (1) and (2) is only meaningful if the hypothetical independent enterprises are assumed to be engaging in the same commercial or financial relation as that between the associated enterprises. The comparison in the first clause of the ALP is only meaningful if the clause is interpreted as “[where] conditions are made or imposed between the two [associated] enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises engaging in the same commercial or financial relations . . . .” The ALP should operate to price associated enterprise transactions, not restrict—upon penalty of recharacterization based on ex post outcomes—the set of transactions among such enterprises to those that independent enterprises would, under various assumptions, normally only engage in.2

Application of Article 9, ¶ 1 requires delineation of the “commercial or financial relations” between associated enterprises, and for this purpose local-country tax law typically includes a form of substance-over-form (or related) principle allowing recharacterization of an associated-enterprise transaction according to its substance. Such recharacterization is required to properly apply Article 9, ¶ 1 if the substance of such transaction doesn’t mirror its form, but Article 9, ¶ 1 itself doesn’t authorize recharacterization in any other circumstances.3 In particular, it provides no authority for a tax administration to make the sorts of adjustments based on ex post evidence contemplated in the Action 8 HTVI PDD. Article 9, ¶ 1 would have to be amended, altering the ALP, to give such authority.4 We recommend that if Article 9, ¶ 1 is so

2 We supported this conclusion in detail in our letter (submitted in conjunction with another trade association), dated February 6, 2015, on the OECD Public Discussion Draft BEPS Actions 8, 9 and 10—Discussion Draft on Revisions to Chapter I of the Transfer Pricing Guidelines (Including Risk, Recharacterisation, and Special Measures (“Comment Letter on BEPS Actions 8–10 PDD”).

3 See § II.A.3 of the Comment Letter on BEPS Actions 8–10 PDD.

4 In response to transfer pricing situations involving hard-to-value intangibles, in 1986 the United States Congress amended § 482 of the Internal Revenue Code—which was interpreted by courts as embodying the arm’s length standard (equivalent to the ALP)—to require that “in the case of any transfer (or license) of intangible property . . . . the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.” This commensurate-with-income language authorized certain transfer pricing adjustments based on ex post evidence. The U.S. Treasury Department and the Internal Revenue Service agreed to interpret such authority in a way
amended, it should be clarified that adjustments under the HTVI approach should be consistent with the ALP.\(^5\) This would allow taxpayers and tax administrations to introduce evidence of behavior of independent enterprises if an HTVI adjustment is contested.

Our remaining comments address aspects of the HTVI approach, and its exemption, on the assumption there exists proper authority for making the sorts of adjustments contemplated in the Action 8 HTVI PDD.

B. **Adjustments of the kind proposed in the Action 8 HTVI PDD should in any case only be made for future transactions involving HTVI**

The sorts of adjustments contemplated in the Action 8 HTVI PDD if the requirements are met should only be made for future associated enterprise transactions involving HTVI—i.e., for HTVI transactions among associated enterprises initiated after any such guidance is finalized. Such prospective implementation would necessarily follow if, as discussed above, Article 9, ¶ 1 were amended to override the ALP to permit such adjustments. There are, however, separate reasons for prospective implementation.

The HTVI approach in the Action 8 HTVI PDD would give tax administrations a new tool under tax treaties, or perhaps under domestic law, for adjusting certain associated enterprise transactions involving HTVI. Critically, actions taken by taxpayers at the time of a transaction involving a given intangible affect first whether the intangible is in fact an HTVI, and second whether the exemption to the HTVI approach will apply.

To the first point, the intangible would be a HTVI if—in addition to there being no sufficiently reliable comparables—either there’s a lack of reliable projections of future cashflows or income expected from intangibles, or the assumptions used in valuing the intangible are highly uncertain.\(^6\) That is, whether or not a given intangible is an HTVI turns on the extent of analysis conducted and information gathered with respect to the intangible. Faced with the new prospect of an adjustment under the HTVI approach, a taxpayer can accordingly be expected to take reasonable steps ex ante to prevent the intangible from being characterized as an HTVI in the first place. These steps could include exercising greater diligence in (i) hunting for comparables, (ii) getting projections of future cashflows or income, and (iii) pressure-testing valuation assumptions.

To the second point, even if an intangible in a transaction is an HTVI, an exemption to an HTVI adjustment applies if the taxpayer provides full details of its ex ante projections used at the time of the transfer to determine the pricing, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and details of the

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\(^5\) This approach was in effect taken by the U.S. Treasury Department in promulgating regulations interpreting the authority to make ex post commensurate-with-income adjustments under § 482 of the Internal Revenue Code. See Treas. Reg. § 1.482-4(f)(2)(i).

\(^6\) Action 8 HTVI PDD, ¶ 9.
comprehensiveness of its consideration of reasonably foreseeable events. A taxpayer in an associated-enterprise transaction involving an HTVI and faced with the new prospect of an adjustment under the HTVI approach can be expected to take reasonable steps to qualify for the exemption to an HTVI adjustment. These steps could include documenting in detail (i) how risks were accounted for ex ante in pricing calculations involving projections, and (ii) how reasonably foreseeable events were considered in the pricing analysis.

Unless the HTVI approach is implemented prospectively, associated enterprises in existing intangible transactions couldn’t exercise either sort of preventive diligence and would thus be prejudiced as against taxpayers entering post-HTVI-implementation intangible transactions. Prospective implementation of the HTVI approach would prevent this inequity.

Application of, or exemption from, the HTVI approach can turn on documentation produced as a result of such HTVI-relevant preventive diligence. Prospective implementation of the HTVI approach would thus be consistent with the delayed implementation of the country-by-country reporting requirement. Although one might distinguish CbC reporting from HTVI-relevant documentation in that the former is mandatory but the latter discretionary, introduction of an HTVI approach can be expected to generate related HTVI analysis and documentation “best practices,” which will also assist tax administrations in auditing HTVI transactions. Prospective implementation of the HTVI approach would allow uniform election by taxpayers of such best practices.

C. Recommendations for specific changes or additions to the rule for making HTVI adjustments proposed in the Action 8 HTVI PDD, and to the proposed exemption, to provide greater certainty

1. Providing greater certainty regarding application of the HTVI approach

Taxpayers routinely engage in associated enterprise transactions involving intangibles, and unless there’s sufficient clarity on when the HTVI approach might be applied such taxpayers face increased uncertainty—beyond that arising under application of current Chapter VI of the TPG—about possible tax administration adjustments to the pricing and terms of such transactions. More precision is needed in describing the HTVI approach, as discussed below.

Without added precision, two serious risks remain with the HTVI approach as drafted. The first risk is that taxpayers entering into associated enterprise transactions won’t be able to determine if an adjustment under the HTVI approach might be made. The HTVI approach gives tax administrations significant new power to adjust transactions, and the second risk is that imprecision in the approach may be used by tax administrations (1) to cast an HTVI net more widely than is justified, and (2) as a justification for recharacterizing terms of associated-

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7 Id., ¶ 14.

8 As stated above in § II.A, we assume that Article 9, ¶ 1 has been modified to provide authority for making adjustments under the HTVI approach.
enterprise transactions. While it mightn’t be possible to provide bright-line rules for application of the HTVI approach as it’s drafted, changes to a few aspects of the approach would decrease the uncertainty.

The first requirement for application of the HTVI approach is that “no sufficiently reliable comparables exist,” but it’s unclear when comparables would be considered “sufficiently reliable.” We recommend replacing the requirement with one requiring absence of any comparables that, through comparability adjustments, could be used as a basis for determining a transfer price.

The second requirement for application of the HTVI approach has two alternative prongs. The first prong is met if there’s “a lack of reliable projections of future cashflows or income expected to be derived from the transferred intangible;” the second prong is met “if the assumptions used in valuing the intangible are highly uncertain.”

The unreliable-projections prong assumes for application that a tax administration can somehow determine if cashflow or income projections are unreliable. The uncertain-assumptions prong assumes a tax administration can determine if valuation assumptions are uncertain. It’s important for application of either prong of this second requirement that hindsight not be used in making these determinations—i.e., that a tax administration not use subsequent (ex post) information to make such reliability or certainty determinations. It might happen that cashflow or income projections are entirely reliable, accurately taking into account all materially relevant factors and reasonably anticipated outcomes, yet events unfold so that actual outcomes deviate from projections. It might conversely happen that projections are inherently unreliable, yet outcomes closely track projections. It’s thus wrong to make inferences about ex ante projection reliability or assumption certainty using proximity of projections to actuals. We recommend the second requirement for application of the HTVI approach clarify that the determinations made under each prong should be based only on information available ex ante. Below in § II.C.4 we discuss some economic issues related to this point.

In connection with reliability of projections and certainty of assumptions, the Action HTVI PDD should clarify that taxpayers can, for example, rely on consistency with ex ante reports of independent analysts, although such reliance wouldn’t be necessary.

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9 As outlined in § II.A, associated-enterprise transactions can be recharacterized under substance-over-form and related local-country law tax principles, but the ALP provides no additional grounds for recharacterizing such transactions.

10 Action 8 HTVI PDD, ¶ 9.

11 No circularity or redundancy arises in connection with the second requirement for exemption from the HTVI approach—i.e., that a taxpayer provide evidence that any significant difference between projections and actuals was unanticipated and due to unforeseeable, extraordinary developments or events. The identification of possible outcomes is only one aspect of the transfer pricing of intangibles—the second requirement for application of the HTVI approach may be met independent of whether or not the second requirement for exemption from the HTVI approach.
2. Providing greater certainty regarding requirements for the exemption from application of the HTVI approach

The exemption to the HTVI approach has two requirements, the first of which is that a taxpayer—

provides full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks;\(^\text{12}\)

This exemption requirement is slightly confusing for four reasons. Are the ex ante projections somehow meant to include risks? Should details of the comprehensiveness of the described considerations be given? What’s the meaning of “other” in “other risks”—i.e., other than what? Does “reasonably foreseeable” also modify “risks”? We recommend the first requirement be clarified as follows to require that a taxpayer—

provides full details of (a) its ex ante projections used at the time of the transfer to determine the pricing arrangements, including (b) how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and (c) the comprehensiveness of its consideration of reasonably foreseeable events and other reasonably foreseeable risks;

This clarification should clear up the confusion.

An exemption to application of the HTVI approach will apply to the transfer of an HTVI if the taxpayer provides “full details” of its ex ante projections and of the “comprehensiveness of its consideration of reasonably foreseeable events and other risks.”\(^\text{13}\) To provide meaningful guidance to taxpayers and tax administrations, these terms should be explained in greater detail. What should be regarded as “full details” of an ex ante projection? Are taxpayers required to identify and assign probabilities to every possible outcome that can be conceived ex ante? If a taxpayer identifies a discrete set of possible scenarios for an intangible (for example, a “base case” along with a few scenarios better and worse than this case), and the actual outcome deviates from the listed scenarios, can a tax administration conclude the taxpayer’s consideration of reasonably foreseeable outcomes wasn’t comprehensive? Hopefully not (as discussed in § II.C.4.a, below). By what objective standard can taxpayers and tax administrators determine if a valuation of intangibles provides “full details” of ex ante projections and is comprehensive in listing reasonably foreseeable outcomes?

The second requirement for exemption from the HTVI approach is that a taxpayer provide[] satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or

\(^\text{12}\) Action 8 HTVI PDD, ¶ 14.
\(^\text{13}\) Id.
extraordinary developments or events occurring after the determination of the
cost or price that could not have been anticipated by the associated enterprises at the
time of the transaction.\textsuperscript{14}

The \textit{Action 8 HTVI PDD} invites respondents to comment on “whether the notion of ‘significant
difference’ in paragraph 13 [and, presumably 14] should be defined, and, if so, what mechanisms
could be used to determine whether a difference between the ex ante financial projections and
the ex post financial outcomes is significant.”\textsuperscript{15}

We believe such notion of “significant difference” should be defined using a mechanism
that takes into account the increasing difficulty of making projections farther into the future.
United States Treasury Regulations, for example, condition exemption from an \textit{ex post}
“commensurate with income” periodic adjustment in part on a taxpayer demonstrating that due
to extraordinary events beyond their control, that couldn’t have been anticipated when the
controlled transaction was entered into, the aggregate profits or cost savings are less than 80
percent or more than 120 percent of the projected profits or cost savings.\textsuperscript{16} Using a 20-percent
“significant difference” window centered on projections is reasonable for the period immediately
following inception of a transfer of HTVI among associated enterprises.\textsuperscript{17} We believe,
accordingly, that “significant difference” should be set at 20 percent.

The \textit{Action 8 HTVI PDD} gives no indication of what constitutes “satisfactory evidence”
in the second requirement for exemption of the HTVI approach. This is unfortunate because the
second requirement in a sense requires a taxpayer to “prove a negative”—i.e., that any such
“significant difference” is due to developments or events that couldn’t have been foreseen or
anticipated. Leaving determination of “satisfactory evidence” to the discretion of tax
administrations injects too much subjectivity and the possibility of great variation in the
standard. We believe a taxpayer should be considered to have provided “satisfactory evidence”
in this case if, in providing ex ante “full details of . . . the comprehensiveness of its consideration
of reasonably foreseeable events and reasonably foreseeable risks,” the taxpayer has considered
all \textit{material} reasonably foreseeable events and all \textit{material} reasonably foreseeable risks. That is,
a taxpayer’s having documented, in determining ex ante its transfer pricing, its consideration of
all material reasonably foreseeable events and risks should be satisfactory evidence any
“significant difference” is due to unforeseeable or extraordinary developments or events that
couldn’t have been anticipated ex ante.

\textsuperscript{14} \textit{Id.} (emphasis added).
\textsuperscript{15} \textit{Id.,} p. 6.
\textsuperscript{17} In § II.C.3, below, we recommend an exemption from adjustment under the HTVI approach if there’s
no significant difference between financial projections and actual outcomes for each year of the five-year period beginning with the first year in which consideration is required to be paid for the HTVI.
3. Adding a time-based exemption from application of the HTVI approach

If a transaction among associated enterprises involves HTVI, the HTVI approach described in the Action 8 HTVI PDD by its terms has no time limitation—i.e., adjustments under the HTVI approach might be made in any post-transaction year during the useful life of the HTVI. There might, for example, be no “significant difference” between ex ante financial projections and ex post financial outcomes for several years post-transaction. In this case the actual use or exploitation of the HTVI over these years fairly closely tracks anticipated use or exploitation, despite initial uncertainty in valuation assumptions or questionable reliability of financial projections. We believe it reasonable that in such a situation the transfer pricing of the transaction shouldn’t, after a certain number of years, be subject to adjustment under the HTVI approach. Such a “cut off” acknowledges the increasing difficulty—for any intangibles—of making accurate projections farther into the future.

We accordingly recommend the Action 8 HTVI PDD be modified to include an additional “cut off” exemption, which could be added to paragraph 14 (following requirements 1 and 2) and worded as follows:

If a taxpayer complies with requirement 1 and if there is no significant difference between the financial projections and actual outcomes for each year of the five-year period beginning with the first year in which consideration was required to be paid for the HTVI, then the approach to a transfer of HTVI described in this section will not apply in any subsequent year.

4. The questionability of using ex post information as “presumptive evidence” of ex ante reliability

According to the Action 8 HTVI PDD, if an intangible is an HTVI—i.e., if (i) sufficiently reliable comparables don’t exist, and (ii) either reliable projections aren’t available regarding future cash flows or income expected to be derived from the intangible, or if assumptions used in valuing the intangible are “highly uncertain”—then ex post information on the actual economic performance of the intangible provides “presumptive evidence” on the reliability of the ex ante information used by taxpayers to determine transfer prices. This reasoning can be circular: ex post information allegedly provides “presumptive evidence” on the reliability of the taxpayer’s ex ante information only if an intangible is deemed to be an HTVI. But in determining an intangible to be an HTVI, a tax administration might first have determined that reliable projections don’t exist.\(^{18}\) In this case, ex post information provides “presumptive evidence” on the reliability of ex ante information in a situation in which a prior determination has already been made on the absence of reliable ex ante projections.

More fundamentally, as a matter of economics, ex post outcomes can’t provide a meaningful measure of ex ante expectations even if a tax administration determines a taxpayer’s ex ante projections are unreliable. Ex post outcomes for an intangible will typically deviate from

\(^{18}\) As noted above, any such initial determination shouldn’t be based on hindsight.
ex ante projections of its performance simply because of the way ex ante projections incorporate uncertainties about the intangible’s performance. Consider the example of an intangible whose performance can take one of two possible courses. With a probability of 40 percent, the intangible will be developed successfully, in which case it will generate €100 in profits. With a probability of 60 percent, however, the intangible will be developed only in a compromised form, in which case it will generate only €25 in profits. The ex ante projection of profits for this intangible is the probability-weighted average of the two possible outcomes, €65 (= 40% × €100 + 60% × €25). Yet, the ex post performance of this intangible can only be either €100 or €25, both of which deviate significantly from the ex ante projection. In this case, it’s absolutely certain that ex post performance will deviate significantly from an ex ante projection that takes uncertainties into account.

What’s apparent in this example is also true in general for intangibles with uncertain outcomes. A probability-weighted average of possible outcomes will typically deviate significantly from most possible outcomes, thus creating a very high likelihood that the actual outcome will deviate significantly from ex ante projections. Even if a tax administration determines that a taxpayer has failed to demonstrate that its ex ante projections are reliable, the actual outcome cannot be “presumptive evidence” of the best ex ante projection. Nor can a deviation in actual outcomes from a taxpayer’s projections be, by itself, “presumptive evidence” that the taxpayer’s projection is incorrect. An economically supportable arm’s length valuation of the intangible necessarily requires development of the best facts possible regarding the ex ante profit potential of the intangible.
SVTDG Member Companies

1. Adobe Systems, Inc.  Barry Slivinsky; Co-Chair
2. NetApp, Inc.   Jeffrey K. Bergmann; Co-Chair
3. Accenture
4. Acxiom Corporation
5. Advanced Micro Devices, Inc.
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41. Integrated Device Technology, Inc.
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43. Intuit Inc.
44. Intuitive Surgical
45. KLA-Tencor Corporation
46. Lam Research Corporation
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66. Seagate Technology
67. ServiceNow, Inc.
68. SMART Modular Technologies Corp.
69. Symantec Corporation
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71. Tesla Motors, Inc.
72. The Walt Disney Company
73. Twitter, Inc.
74. Uber
75. Visa
76. VMWare Corporation
77. Xilinx, Inc.
78. Yahoo!, Inc.
18 June 2015

Via E-Mail
TransferPricing@oecd.org

Mr. Andrew Hickman
Head of Transfer Pricing Unit
OECD Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16
France

OECD Discussion Draft: BEPS Actions 8 – Hard-to-Value Intangibles

Dear Mr. Hickman

The business federation SwissHoldings represents the interests of 61 Swiss based multinational enterprises from the manufacturing and service sectors (excluding the financial sector). SwissHoldings is pleased to provide comments on the OECD Discussion Draft of the Proposed Modifications to the existing guidance in Section D.3 of Chapter VI (hereafter referred to as “the Draft”).

Our comments to the Draft are as follows:

1. We would like to highlight that the valuation of intangible transfers within an MNE and the respective determination and documentation of the arm’s length price is a challenging task for taxpayers. In addition, the valuation of intangibles generally includes a certain element of uncertainty with regard to valuation parameters. Nevertheless, in practice, standard valuation models have been developed and applied many times which are generally accepted by taxpayers and tax authorities for the majority of the intangible transfers.

2. Hence, in order to avoid the risks for disputes and disproportionately increase the compliance burden for MNE, the Draft should “only” focus on the development of the Transfer Pricing Guidelines as such and not on the introduction of unclear “special measures” which go beyond the arm’s length principle.

3. The current draft defines hard-to-value intangibles (HTVI) broadly which could effectively lead to the introduction of the so called “commensurate with income approach” as a new standard for the evaluation of intangibles, i.e., the current Draft would make ex-post adjustments to the new rule/standard which is not arm’s length in most situations. Based on our experience ex-post adjustments are the exception and not the rule. Moreover, potential ex-post adjustments are limited with regard to the applied time frame.

4. Hence, we recommend clarifying that the arm’s length principle remains the leading standard. The OECD should limit the content of the Draft to the key message, i.e., when evaluating the transfer of intangibles the arm’s length principle may require - in exceptional cases - the inclusion of price adjustment clauses as discussed in Par. 3 or the “renegotiation of the pricing arrangements where it is to their mutual benefit” as discussed in Par. 4 of the Draft. Further lengthy explanations or definitions or even the term “HTVI"
are not needed as they do not solve the requirement that each intangible transfer needs to be analysed separately in light of the arm’s length principle.

5. The OECD has to further clarify and state in the Guidelines that special measures like price adjustment mechanisms are only applicable in exceptional limited cases with a clear and very narrow definition of HTVI (if needed at all). The possibility of tax administrations to arbitrarily apply the HTVI regulations ex-post must be limited as much as possible to provide legal certainty for taxpayers and to minimize double taxation risks. It should not be used as an avenue by tax administrations to unduly penalise taxpayers who do not have the benefit of hindsight at the point of valuing the intangible / HTVI. As the Draft is written now, it provides tax authorities an unbalanced and one-sided right for ex-post adjustments.

6. The contractual terms (including/or excluding price adjustment clauses as an option by the taxpayer to be considered and documented ex-ante) needs to be respected by the tax authorities. The burden of proof for another treatment needs to remain with tax authorities and not be devolved to the taxpayer. A clarification on this point would be appreciated.

7. The language of the Draft is one-side. Please consider that the OECD Transfer Pricing Guidelines are the guidelines for Tax Administrations and MNEs. The Draft should be rephrased in a way that makes clear that the concept of HTVI is not a tool for tax administrations to justify ex-post and retroactive price adjustments, but mainly a valuation requirement that should be followed by taxpayers at the time of the intangible valuation when required by the arm’s length principle and should be accepted by the tax administration accordingly.

8. When the intangible is evaluated the lack of information is also on the side of the taxpayer due to the nature of intangibles/HTVI. Accordingly, the Draft should highlight that the uncertainty or lack of information is not only with the tax administration, but also with the taxpayer. The taxpayer needs to determine an arm’s length price which is accepted by the involved tax administrations to avoid time consuming and costly controversy as well as potential double taxation. For intangibles/HTVI there is no information asymmetry between taxpayer and tax administrations (for example as mentioned in Par. 11), but an increased uncertainty about the intangible value which is also the case for the transfer of certain intangibles between third parties.

9. The lack of information on the tax authorities' side should be addressed with appropriate transfer pricing documentation which the taxpayer has to prepare based on Chapter V of the Guidelines and not with retroactive price adjustments. When the taxpayer has provided appropriate transfer pricing documentation the burden of proof is with the tax administrations.

10. In Par. 10 it should be clearly stated that even if an intangible exhibits one or more of the listed features the intangible may not fall into the category of HTVI if third parties in similar circumstances would not have applied special measures. For example, depending on the case partially developed intangibles may allow reliable ex ante projections.

11. For MNEs price adjustment mechanisms are complex to implement and require significant administrative efforts. For example, already after a few years, financial data related to a specific intangible may not be available anymore as the MNE’s financial reporting systems and processes are often not designed to capture intangible related financial data or the intangible may have been embedded or mixed with other intangibles. As the Draft is written now, it would significantly increase the compliance burden.
12. As indicated above price adjustment clauses are the exception and limited with regard to the applicable time horizon. Hence, we would appreciate if the OECD states a maximum time horizon of 1 to 3 years for which price adjustments clauses could be considered and applied by the taxpayer, unless it can be proven that third parties would have agreed on a longer time horizon. Based on our experience third parties do normally not agree on price adjustment clauses with a time horizon longer than 3 years (exceptions are observed with regard to compensation for specific “liabilities/risks” in M&A deals). Any longer time horizons will result in double taxation.

13. With regard to item (1) of the Additional Points: The Draft does generally not improve certainty for taxpayers. In fact, it does the opposite.

14. With regard to item (3) of the Additional Points: As stated above, SwissHoldings believes that the application of special measures for intangible valuations should be largely driven by the arm’s length principle which requires a separate analysis in each case. Therefore, from our view the notion of “significant difference” cannot be further defined.

15. With regard to item (4) of the Additional Points: As stated above the OECD should focus on the applicable time frame for price adjustment clauses (i.e., max. 3 years) and provide further guidance on how the clause could be structured.

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We kindly ask you to take our comments and proposals into due consideration.

Yours sincerely

SwissHoldings
Federation of Industrial and Service Groups in Switzerland

Christian Stiefel  
CEO

Dr. Martin Zogg  
Member Executive Committee

cc  - SwissHoldings Board
- Nicole Primmer, Senior Policy Manager, BIAC
- William Morris, Chair of the BIAC Tax Committee
- Krister Andersson, Chair BUSINESSEUROPE Tax Policy Group
Andrew Hickman
Head, Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation and Development
Paris, France

Via Email: transferpricing@oecd.org

RE: Public Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles

Dear Mr. Hickman:

On 19 July 2013, the OECD published an Action Plan on Base Erosion and Profit Shifting (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries’ tax bases are being eroded or profits shifted improperly. Pursuant to Action 8 of the Plan, on 4 June 2015 the OECD issued a public discussion draft entitled BEPS Action 8: Hard-to-Value Intangibles (hereinafter the Discussion Draft or Draft).

The OECD solicited comments from interested parties no later than 18 June 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD’s request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws,
at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.¹

**TEI Comments**

**General Comments**

TEI commends the OECD for its work on hard-to-value intangibles as reflected in the short and succinct Discussion Draft. The abridged nature of the Draft makes it possible for stakeholders to provide input within the 14 day deadline provided, although that period is far too short for such an important issue. Regrettably, even in such a short Discussion Draft it seems the OECD still cannot produce a consensus view on this critical topic. If a consensus approach is not developed for hard-to-value intangibles by the end of the BEPS project, then tax authorities will likely adopt different views and methods, leading to controversy and double taxation. TEI urges the OECD and the states participating in the BEPS project to find a reasonable and consistent approach to the issues surrounding hard-to-value intangibles and avoid the negative outcomes that will result if varying methods are adopted across jurisdictions.

**Specific Comments**

Paragraph 4 of the Discussion Draft seems to indicate that independent enterprises are able to re-negotiate agreements if major unforeseen developments occur. In TEI’s experience, however, such re-negotiations are extremely rare, and even a “re-pricing” or some sort of after-the-fact review of contract terms are not common in contracts between unrelated parties. It is true that, as noted in paragraph 3, agreements may be structured to minimise the business risk of a “bad deal,” such as a shorter contract term, or through the use of a price adjustment or contingent payment mechanism based upon meeting certain milestones. Needless to say, in contracts between unrelated parties these terms are set at the outset of the contract through negotiations using only *ex ante* information. And we again note that it is rare for a contract to provide for a full re-negotiation or re-pricing if unforeseen circumstances arise. The possibility of unforeseen events and circumstances is typically part of the business risk that each enterprise assumes, for better or worse. Moreover, milestone or price adjustments between unrelated parties typically only span a short period, generally no more than three years even if the full contract term is longer. This should be noted in the Discussion Draft, which currently reads as if such price adjustments are open ended and thus seemingly allows for the use of *ex post* results and information at any time during the contract term to retroactively adjust pricing.

¹ TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).
The key limiting factor in the Draft’s discussion about the renegotiation of contracts between unrelated parties is that a renegotiation may occur if it is to the parties’ “mutual benefit.” In TEI’s view, this is a critical qualification that must be satisfied (among other things) before tax authorities are permitted to adjust the terms of a contract between related parties. Tax authorities should not be able to modify contract terms or pricing merely because one of the parties obtained a significantly better deal than expected. Any such renegotiation must also be to the advantaged party’s benefit, as would be the case in a renegotiation between unrelated parties in circumstances where one side received unanticipated benefits.

Nevertheless, the Discussion Draft essentially condones the use of hindsight by allowing tax authorities to use ex post evidence and presume that an intangible is mispriced if there is a significant difference between the ex post “correct” price (the “actual financial outcomes” in the Draft’s phrasing) and the ex ante price unless the taxpayer meets the criteria listed in paragraph 14. This approach would be a significant departure from long established transfer pricing principles. It is extremely difficult for multi-national enterprises (MNEs) to perform financial forecasts of new products and services, although the Draft seems to assume that MNEs can easily produce accurate forecasts and then use that ability to engage in base erosion and profit shifting related to intangible assets. The Discussion Draft, by requiring probability-weighted risks and comprehensive consideration of reasonably foreseeable events and other risks, would place an unreasonable administrative burden and cost on the taxpayer as such information is often not available and, indeed, may often go beyond the information considered when making the relevant business decision. This requirement will merely increase disputes and result in uncertainty for taxpayers. The ex post approach in the Draft is also one-sided, only permitting tax authorities to use subsequent information to adjust transfer prices. If this approach is to be accepted by the OECD, then it should also condone taxpayers using ex post information when pricing turns out to be significantly unfavorable to the taxpayer under similar circumstances.

TEI appreciates the OECD’s solicitation of comments as to how taxpayers can be permitted to show that their ex ante pricing was appropriate via methods other than the one listed in paragraph 14. These methods should include where the taxpayer has an advanced pricing agreement with the relevant tax authority. Another permitted method should be where the taxpayer has contemporaneous transfer pricing documentation that has been completed with due care and consideration and the methodology used has previously been accepted by the tax authority. A taxpayer should be able to provide evidence that unrelated parties would not have included a price adjustment or other renegotiation clause in the contract in similar ex ante circumstances, even if the ex post results differ extraordinarily from ex ante expectations. Relatedly, TEI recommends that the phrase “provides full details of its ex ante projections” in section 1 of paragraph 14 be amended to read “provides significant details of its ex ante

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2 Discussion Draft, p.3.
3 Id. at 5.
projections” to decrease the compliance burden on taxpayers and to avoid inundating tax authorities with minor and insignificant details.

A mechanism that could be used by tax authorities to evaluate the thoroughness of the *ex ante* pricing and projections is evidence of internal discussions and/or sign-offs. In third-party negotiations of hard-to-value intangibles the parties will often challenge the projections used by the other party before finalising the deal, and there will be discussions on the various assumptions that underlie the projections. After that discussion, however, the deal is “closed” and not subject to renegotiation regardless of subsequent “significant differences” that might develop in the financial results.

Paragraph 13 states that permitting tax authorities to adjust the prices of hard-to-value intangibles should be “applied only in situations where the difference between *ex post* outcomes and *ex ante* outcomes is significant . . . .” The Draft then asks for comments on whether “significant difference” should be defined and, if so, how. TEI believes that such a critical term should be defined to avoid unprincipled assertions by tax authorities that almost any difference between *ex ante* and *ex post* results is significant. Thus, the OECD should further state in final recommendations that this method is to be applied rarely, and also include a requirement that the difference in results must be both greater than a certain percentage of the *ex ante* price and above a dollar threshold. A requirement that the dollar threshold be material to the taxpayer would also be welcome.

As a way to provide greater certainty to taxpayers in this area, the OECD could recognise the use of imperfect comparables for the purpose of determining whether a price adjustment mechanism would be included in a contract between unrelated parties. For example, if an MNE has purchased a tradename from an unrelated party and no price adjustment clause was included, the OECD could recognise that this as evidence that no price adjustment clause would be appropriate where a tradename has been purchased from a related party. In other words, while the value of the unrelated-party purchased tradename may not be an accurate comparable value for a different related-party purchased tradename, the lack of a price adjustment clause in the third-party tradename purchase may be used as evidence that no price adjustment clause would be provided for in the related-party purchased tradename.

Finally, the OECD should state in its final guidance on hard-to-value intangibles that any changes to current approach to valuing intangibles only should be applied by tax authorities prospectively. That is, only to transaction occurring after the final guidance is adopted by a particular jurisdiction. A retroactive application of the guidance in the Discussion Draft would upset taxpayers’ justified reliance on the rules in place when previously valuing intangibles.
Conclusion

TEI appreciates the opportunity to comment on the OECD Discussion Draft regarding hard-to-value intangibles under BEPS Action 8. These comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of TEI’s legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Mark C. Silbiger
International President
June 18, 2015

VIA E-MAIL – TransferPricing@oecd.org

Mr. Andrew Hickman
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Organisation for Economic Co-operation and Development
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2, rue André Pascal
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Re: Treaty Policy Working Group Comments on the Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles

Dear Mr. Hickman:

We are writing to share the comments of the Treaty Policy Working Group on the Discussion Draft on “hard-to-value intangibles,” which was released on 4 June 2015 for comment by 18 June 2015.

The Treaty Policy Working Group (TPWG) is an informal association of large global companies based throughout the world that represent a broad spectrum of industry sectors. The TPWG has been working since 2005 with the OECD, and more recently with the UN, to analyze and provide constructive comments on tax policy and administration concerns regarding transfer pricing, permanent establishment (PE), profit attribution, and related issues that are critical to our ability to avoid double taxation and conduct international trade and investment. The TPWG has provided comments on and participated in virtually every consultation regarding OECD and BEPS discussion drafts on transfer pricing issues over the past decade and also provides input on the UN work in this area.

The TPWG is pleased to comment on the Discussion Draft, which addresses issues of great importance to our member companies.

1 The membership of the Treaty Policy Working Group is currently comprised of the following companies: Amazon.com, Inc.; BP plc; Cisco Systems, Inc.; Procter & Gamble Co.; Salesforce.com Inc.; TD Bank Group; Thomson Reuters Corporation; Tupperware Brands Corporation; and Vodafone Group plc.
Executive Summary

We appreciate the concerns of tax administrations regarding potential information asymmetry in the valuation of certain hard-to-value intangibles. To the extent that it is intended to create an incentive for taxpayers to share additional information that is available to them at the time of the transaction, the Discussion Draft seems to focus on a conceptually appropriate remedy for this concern.

The stated intent to evaluate the taxpayer’s transfer price by reference to what independent enterprises would have agreed at the time of the transaction is welcome as well, as it is more consistent in concept with the arm’s length principle than are other approaches.

We were also pleased to hear in discussions at recent conferences that the Discussion Draft’s proposals are intended to apply in lieu of the “special measures” previously proposed in connection with Actions 8-10. We see these as positive steps.

The Discussion Draft leaves open a number of questions, however, about how valid tax administration concerns can best be addressed without creating other serious asymmetries, uncertainties, and controversies. We are concerned that, as it now reads, the Discussion Draft could be applied in practice to most intangibles, with broad latitude for tax administrations to recharacterize the taxpayer’s transaction and no clarity regarding the effect of such recharacterization. This scope would benefit the more aggressive tax administrations and create an untenable level of uncertainty for taxpayers.

To avoid this, we recommend that the next draft of this guidance include a statement of principle to provide a more concrete foundation. The current draft is unusually ambiguous, even in central features such as the definition of a HTVI, the circumstances in which a taxpayer “should have foreseen” a development or event that had not yet occurred, how a taxpayer might demonstrate that it has properly “probability-weighted” any number of commercial risks in the marketplace, and even the nature of the remedies available to tax administrations. To address this need for a clear statement of principle, we recommend that the following confirmation be included in the Guidelines:

“The purpose of the HTVI guidance is to provide tools to tax administrations to address potential information asymmetries. Consistent with that purpose, the guidance in this section D.3. is intended to be used solely for the purpose of assessing the reliability of the judgment exercised by the taxpayer at the time the transaction occurred. This guidance cannot be used to support an adjustment to the taxpayer’s price based solely on a divergence of results from the ex ante valuation, unless the taxpayer’s judgment at the time of the transaction is shown to have not taken into account material factors which would have been considered

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2 OECD International Tax Conference (June 10-11, 2015); Bloomberg BNA/Baker & McKenzie Global Transfer Pricing Conference (June 11-12, 2015).
by unrelated parties. Any other use of ex post information would constitute an impermissible use of hindsight.”

The following comments discuss our key concerns regarding the Discussion Draft and suggest additional clarifications.

I. Definition

The Discussion Draft proposals apply by their terms only to a “specific category” of intangibles defined as “HTVI.” This could be helpful if the definition were more precise or targeted. However, the definition of HTVI seems potentially broad enough to include most “intangibles,” which are themselves very broadly defined in other proposed changes to Chapter VI of the Transfer Pricing Guidelines.

An intangible is defined as an HTVI if, at the time of its transfer, (1) no “sufficiently reliable” comparables existed, and (2) there was a lack of “reliable projections” of future cash flows or income or the assumptions used in valuing the intangible were “highly uncertain.” The definition thus requires a series of patently subjective determinations for which no specific guidance is provided. The Discussion Draft further suggests that HTVI may include intangibles that are anticipated to be exploited “in a manner that is novel at the time of the transfer.” Finally, the Discussion Draft indicates that even intangibles that are not hard to value may be included by association, if “connected with the development or enhancement” of an intangible that is an HTVI. Again, neither “novel” nor “connected” is explained, and the rationale for sweeping such intangibles into HTVI is not clear.

We understand that the Discussion Draft was prompted by concerns regarding the valuation of intangibles arising from in-process R&D. If so, it would seem appropriate to limit the reach of the HTVI rules to such cases. This would allow the other, less subjective provisions of Chapter VI (as well as Chapter III) of the Transfer Pricing Guidelines to continue to apply to most intangibles and would avoid creating uncertainty and controversy regarding their valuation. At a minimum, the suggestion that all intangibles that are “connected with” an HTVI may themselves be treated as HTVIs should be withdrawn, and other unclear statements regarding its scope should be clarified. In addition, to avoid any ambiguity, all provisions regarding the scope of HTVI should be provided in its definition, not only by example.

II. Hindsight

We appreciate the Discussion Draft’s acknowledgment that the concerns of tax administrations regarding potential information asymmetry must be addressed without the inappropriate use of hindsight. However, we are concerned that some aspects of the Discussion Draft proposals could, in fact, permit the inappropriate use of such hindsight in many cases. This would replace one potential asymmetry with another. The use of hindsight by tax administrations alone would be particularly unfair, as they could be expected to adjust transfer prices only upwards and to
resist any decreases or corresponding adjustments to account for less favorable results (or vice versa, in the case of transferee jurisdictions).

If these rules are intended to allow tax administrations to use ex post information as the presumptive basis on which to make adjustments (as opposed to using such information to assess the reasonableness of the taxpayer’s judgment at the time of the transaction), then the Guidelines must also allow taxpayers to use ex post information to make presumptive adjustments to the prices as originally determined under the same circumstances. The relevant domestic law provisions would also need to be amended as necessary to permit this. Otherwise, the rules are operating as a mechanical one-sided adjustment mechanism that does not acknowledge the fact that in unrelated party transactions, the realization of risks is highly variable, and that it cannot be foreseen with any degree of certainty how ordinary commercial risks will be resolved.

We believe that the following safeguards need to be added to prevent the inappropriate use of hindsight:

A. It should be confirmed that financial outcomes and other “ex post information” will not be treated as “presumptive evidence” that the ex ante information used by the taxpayer in determining the transfer price was unreliable.

Any conclusive presumption that ex post information is the most reliable measure of arm’s length pricing would permit the unfettered use of hindsight and should be clearly rejected.

Ex post information should be treated instead as additional information to be considered in specified circumstances, together with the information used by the taxpayer in making its ex ante determination, to evaluate the reliability of that determination. This is presumably what was intended, as suggested by the description of ex post information as, variously, “a pointer,” “an indication,” and “relevant information” elsewhere in the Discussion Draft, but the reference to “presumptive evidence” in paragraph 9 needs to be removed to avoid confusion. Paragraph 12 comes closer to articulating an appropriate standard, with its statement permitting “the consideration of ex post evidence” only “when and in so far as there is no other information to assess the reliability of the information on which ex ante pricing has been based.” A standard along the lines of paragraph 12 should be used uniformly throughout the text to avoid any uncertainty regarding the probative effect of ex post information. This is particularly important because many of the terms that are more consistent with the appropriate use of such information appear only in the introductory text, while the text in paragraph 9 that appears to be intended as the operative rule makes by far the strictest statement of any provision in the document, referring to ex post information as “presumptive evidence.”

Similarly, where the taxpayer based its ex ante transfer pricing determination on projections used at the time for other business purposes, such as presentations to potential funders or in investment approval presentations to its board of directors, that information should be presumed
reliable for valuation purposes. The Guidelines should clearly so provide to avoid the inappropriate use of ex post information in such circumstances.

B. The situations in which ex post information may be considered should be clarified to avoid overreach.

In its current form, the Discussion Draft suggests that ex post information may be considered only where (1) there is a “significant difference” between ex post outcomes and ex ante projections, and (2) that difference is due to developments or events that “were or should have been foreseeable at the time of the transaction.”

This standard sounds reasonable enough on its face, but we believe it would prove unworkable in practice. It is vulnerable to overbroad application in at least two respects.

First, as the term “significant difference” is not defined, the use of ex post outcomes to second-guess transfer prices in hindsight could become the rule rather than the exception. This would create an untenable level of uncertainty for taxpayers and would disadvantage the more principled tax administrations. To avoid creating this situation, the Discussion Draft needs to define the term “significant difference” or at least provide a clearly defined safe harbor, as the United States did in response to concerns raised by its treaty partners following its adoption of statutory commensurate-with-income provisions. We understand that some may be reluctant to provide a range defined by specific mathematical parameters, but we believe that, if structured as a safe harbor, this approach would not be inconsistent with the arm’s length principle as it has been applied in other contexts.

The second issue with the proposed approach to ex post information is that, as stated by paragraph 13, it turns on whether the developments or events giving rise to the difference “were or should have been foreseeable” at the time of the transaction. The standard is stated in varying and potentially inconsistent terms throughout the Discussion Draft, including the following:

- “the relevant developments or events that might have been expected to affect the value of the intangible and the pricing arrangements adopted” (paragraph 7);
- “the foreseeable developments or events that are relevant for the valuation of the intangibles involved” (paragraph 8);
- “reasonably foreseeable events and other risks” (paragraph 14.1);
- “unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction” (paragraph 14.2); and
“what was foreseeable at the time of the transaction and reflected in the pricing, and that the developments leading to the difference between projections and outcomes arose from unforeseeable events”; “for example … a natural disaster or the unexpected bankruptcy of a competitor that was clearly unforeseen at the time of the transaction” (paragraph 15).

This discussion is prefaced by a frank admission of the challenges faced by tax administrations in evaluating such issues:

“A tax administration may find it difficult to establish or verify what developments or events might be considered relevant for the pricing of a transaction involving the transfer of intangibles or rights to intangibles, and the extent to which the occurrence of such developments or events, or the direction they take, might have been reasonably foreseeable at the time the transaction was entered into.” (Paragraph 6.)

The proposed approach thus places the burden on the taxpayer to demonstrate that the difference between projections and outcomes was due to unforeseeable events, however defined, and might be misunderstood as permitting tax administrations to treat any difference not due to such events as potentially attributable to inappropriate transfer pricing. It is, therefore, important for these provisions to articulate a single, clear standard. Particular care should be taken not to provide a subjective standard that depends on determinations by tax administrations that are admittedly ill-suited to this task.

The standards articulated in paragraph 7 (“might have been expected”), paragraph 13 (“were or should have been foreseeable”), and paragraph 15 (natural disasters and unexpected competitor bankruptcy as the sole examples of “unforeseeable events”) seem to set an unclear or too-high bar. A clearer and more appropriate standard should be applied consistently throughout, both to establish what the taxpayer must demonstrate to prevent a challenge to its ex ante determination and, conversely, to define the conditions under which tax administrations may consider ex post information to evaluate the reliability of that determination.

Provided that the same standard applies to both taxpayers and tax administrations, it seems reasonable to ask whether the taxpayer failed to account adequately ex ante for “foreseeable” developments or events. However, the key concept of foreseeability needs further explanation to avoid disparate application. For this purpose, the taxpayer should be required to prove that it appropriately took into account all developments or events that were reasonably foreseeable at the time of the transaction. If taken into account by the taxpayer ex ante, such events would not provide grounds for applying the HTVI provisions. Events that were not reasonably foreseeable, including but not limited to those such as volcanic eruptions and unexpected bankruptcies, should also be outside the scope of the HTVI provisions. So the HTVI provisions should apply
only in cases where the taxpayer did not properly take into account events that were reasonably foreseeable by it at the time of the transaction.

On the other hand, events that were foreseeable and reflected with proper weighting in the taxpayer’s valuation should be considered to have been adequately accounted for in the taxpayer’s ex ante pricing, even if the prospect of their occurrence was relatively remote at the time. For example, all of the “business risk” disclosures in a company’s 10K (or similar financial statement) are foreseeable, but few are likely. The fact that one of these risks materializes does not mean that management did not prudently value the company’s transactions. Even if a taxpayer reasonably takes into account the possibility that an occurrence or event may be realized, unless the probability of its occurring is 100 percent the actual results necessarily will deviate to some degree from the taxpayer’s projections. The mere fact that there is a deviation is not a per se demonstration that the taxpayer’s assessments were not reasonable. In other words, the HTVI provisions should apply only where the taxpayer did not appropriately take into account normal business risks and should not apply simply because a relatively low likelihood of a foreseeable occurrence materializes favorably. Otherwise, a tax administration might argue that anything that causes the actual financial results to deviate from the taxpayer’s projections is due at least in part to something that could have been foreseen. It obviously would be inappropriate for the Guidelines to support an adjustment wherever a foreseeable (but not certain) risk has been realized, simply because that development or event ultimately did occur. Thus, it should be confirmed explicitly that a valuation will not be considered unreliable for purposes of the HTVI provisions solely because it assigns a low probability to a risk that subsequently materializes against the odds, if the probability weighting was reasonable and was taken into account in setting the transfer price.

To ensure the balanced application of these principles, we recommend that paragraph 14.2 be amended to read as follows:

“provides satisfactory evidence that the material developments or events that should have been foreseeable were reasonably accounted for in the taxpayer’s determination of the price at the time of the transaction.”

Consistent terminology should be used in paragraph 13 and throughout the Discussion Draft. In addition, to ensure that the meaning of “foreseeable” is not misunderstood, the natural disaster and competitor bankruptcy examples provided in paragraph 15 should be supplemented with more pertinent examples, such as unanticipated demand due to unexpected advancements in products for which components are supplied, competitor recalls, and unsolicited celebrity endorsement.

It should be sufficient for the taxpayer to document ex ante the risks evaluated and the probability assigned to each. To encourage this desired provision of information, the Guidelines should spell out exactly what information taxpayers need to show they considered at the time of
the transaction in order to establish the reasonableness of their ex ante analysis and avoid a review based on ex post information. This approach would be consistent with general transfer pricing documentation principles and would provide a well-targeted remedy for information asymmetry.

### III. Operation

The Discussion Draft identifies a conceptually correct approach to determining an arm’s length price – looking to what independent enterprises in similar circumstances would have done – but unfortunately fails to specify clearly either how this determination would be made or what the consequences would be.

As for the determination of what independent enterprises would have done, the Discussion Draft correctly notes that they may agree to account for highly uncertain valuation in a variety of ways, including:

- Pricing to reflect anticipated benefits;
- Adopting a shorter-term agreement;
- Including price adjustment clauses in the agreement;
- Adopting a payment structure with periodic milestone payments;
- Setting a royalty rate to increase as sales of the licensee increase;
- Requiring additional payments when development targets are achieved;
- Requiring payment of additional contingent amounts payable on achievement of milestones; or
- Renegotiation of the agreement.

There is, however, no guidance provided on how the terms of the hypothetical independent enterprise agreement would be determined, or who would make the determination, in what circumstances, and on what grounds. This seems likely to prompt widespread recharacterization of taxpayers’ transactions, with the attendant uncertainties and risks of unrelieved double taxation.

As elsewhere in the Transfer Pricing Guidelines, tax administrations generally should be discouraged from recharacterizing transactions and should respect the taxpayer’s transfer pricing method if that method is otherwise acceptable. This is especially important for HTVI, given the acknowledgment in the Discussion Draft that tax administrations often lack the practical business experience and specialized industry knowledge necessary to determine whether an event was
reasonably foreseeable. Therefore, we believe that this portion of the Discussion Draft needs to provide additional guidance to ensure that tax authorities minimize recharacterizations.

A second operational issue is that the Discussion Draft does not specify the consequences of challenges to the valuation of HTVI. It refers to the difference between the taxpayer’s ex ante valuation and the ex post financial outcomes, and indicates that if the difference is “significant” and other requirements are met, the taxpayer may be suspected of “mispricing.” But it does not indicate whether the “mispricing” would be deemed to equal the difference between the taxpayer’s reported price and the price which would have resulted if the taxpayer had applied its original method using the ex post information, or would be determined in another manner. This is a major gap that needs to be addressed affirmatively by the Discussion Draft to avoid conflicting interpretations.

The proposed guidance suggests in one passage that the tax administration “should be permitted to determine the pricing,” although this text does not appear in the operative provisions. To ensure consistency with the Guidelines mandate to use the most reliable method, tax administrations should be directed to use the most reliable example of what independent parties would have done. Just as taxpayers are required to justify the quality of their proposed comparables and the reliability of their adjustments, if the tax administration is to be given the authority to apply a method different than what the taxpayer used, then a similar “most reliable” standard needs to apply to determine what alternative pricing method, if any, the tax administration can impose.

Finally, the Guidelines should confirm that there is no need for the HTVI proposals to apply if the taxpayer itself adopted a contingent pricing mechanism of any of the types referenced in paragraphs 2-4, which the taxpayer demonstrates is a method used by third parties to set a price for similar transactions.

IV. Double Taxation

The Discussion Draft should also confirm explicitly that any adjustments made pursuant to its guidance on HTVI will be eligible for relief from double taxation under applicable bilateral tax treaties. This is appropriate because, if that guidance is clarified as suggested to remain focused on the reasonableness of the taxpayer’s ex ante determination, the proposals do appear consistent with the arm’s length principle.

To ensure relief from double taxation notwithstanding the extended statutes of limitation for transfer pricing adjustments in some countries, it will likely be necessary to impose a corresponding limit on the period during which an adjustment may be made in respect of an HTVI (as with the limited five-year “look-back” for applying the U.S. commensurate-with-income provisions). Another alternative would be to extend the period allowed under domestic

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3 Discussion Draft, paragraph 5.
law for the claim of a foreign tax credit, but this remedy is not likely to be widely available in practice.

V. Effective Date

Given that a key point of the Discussion Draft is to create incentives for taxpayers to provide additional information regarding their ex ante valuations, fairness dictates that any special HTVI rules that may be adopted should be applied only with prospective effect.

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The Treaty Policy Working Group hopes that these comments will be helpful as deliberations continue on these important issues. We would welcome the opportunity to discuss our concerns further as comments on the Discussion Draft are considered.

Sincerely yours,

For the Treaty Policy Working Group

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June 18, 2015

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Re: USCIB Comment Letter on the OECD DISCUSSION DRAFT: BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES

Dear Mr. Hickman,

USCIB\(^1\) thanks the OECD for the opportunity to provide comments on its discussion draft on Action 8 (Hard-to-Value Intangibles or “HTVI”) of the Base Erosion and Profit Shifting (BEPS) Action Plan issued 4 June 2015 (the discussion draft).

It is unfortunate, however, that the time available to provide comments was so very short. We have had very little opportunity to consult with our members. Those consultations have made clear that many practical issues will arise in the implementation of the proposed guidance. We will continue to seek input from our members and may follow-up with additional comments before the public consultation, especially if we can identify particular examples that the guidelines should address.

Comments

USCIB welcomes the discussion draft’s emphasis on what independent enterprises would have done in comparable circumstances\(^2\) and appreciates the tax authorities’ difficulties in dealing

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\(^1\) USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.

\(^2\) There is no discussion in the discussion draft of whether these proposals are considered a special measure and if so whether these measures are outside of the arm’s length standard. If the proposal is not consistent with the
with information asymmetry. We also welcome the OECD’s recognition that the provisions are only intended to apply where:

[T]he difference between expected and actual outcomes cannot be explained by considerations other than inappropriate pricing.\(^3\)

In our view, it is critical that this statement be moved into the text of the transfer pricing guidelines as it is important to the interpretation of the rules and will be lost if not moved into the text of the guidelines.

Paragraph 9 provides that tax administrations “may” adopt the approaches outlined in the discussion draft. If the discussion draft represents an application of the ALS, then USCIB believes that it is necessary that tax administrations apply the arm’s length standard as consistently as possible and therefore the application of the proposals should not be elective.

USCIB believes that it is critically important that the scope of Action 8 be carefully limited. In particular, it seems that the description of HTVI in paragraph 10 of the discussion draft could apply to virtually every intangible and therefore is not helpful guidance. Are all intangibles only partially developed because companies are constantly updating their technology? Are the proposed rules intended to cover corporate synergies or local marketing intangibles? How long is several years? Are there any limits on the ability of governments to look back? What does it mean that “intangibles are anticipated to be exploited in a manner that is “novel” at the time of the transfer”? USCIB does not find the statements in paragraph 10 clarifying and believes they either need further definition or ought to be deleted.

Paragraph 9 of the discussion draft provides:

[E]x post information provides presumptive evidence as to the reliability of the information used ex ante in determining the transfer price for the transfer of such intangibles or rights in intangibles.

In determining when an adjustment may be necessary, the proposed guidelines should recognize that in virtually every case ex ante and ex post returns will diverge because ex post results reflect the realization of risk and other events rather than their anticipation. So, it is very important that the proposed guidance does not apply in the absence of significant divergences between ex ante and ex post results. The OECD should adopt a standard that if the ex post results are within 80% to 120% of the ex ante projections, then no adjustment should be required under these provisions. Further, the ex post results should be examined from a

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\(^3\) Discussion draft, box, page 1.
multiple-year perspective (perhaps 5 years) such that individual year anomalies are smoothed out.

It is also important that paragraph 14 of the discussion draft be clear, so that taxpayers can evaluate whether their ex ante documentation is adequate to protect them from ex post changes to their pricing. Because the focus of these guidelines is information asymmetry, the exception provided by this paragraph seems to be appropriately focused on ensuring that the taxpayer did a thorough job of analyzing and documenting its projections. It would, therefore, be useful if the guidance under Action 8 were tied to the transfer pricing documentation under Action 13. That is, Action 8 should not be imposing an additional burden and the requirements of paragraph 14.1 should be considered satisfied if the taxpayer provides the information required by the master file and local file with respect to the transaction. If more information is intended to be required then that information should be clearly identified.

Paragraph 14.2 requires that any significant difference between the financial projections and the actual outcomes be attributable to unforeseeable or extraordinary developments or events that could not have been anticipated by the taxpayer. This standard is unclear and unreasonable. Is a recession or economic boom unforeseeable or something that could not be anticipated by the taxpayer? Disposable income in an economy may have a significant impact on the ability of consumers to purchase goods and services and may have a significant impact on projections. Such events may be foreseeable in the sense that economic cycles are foreseeable, but the timing and extent of such swings are unpredictable and outside of the taxpayers control and may affect projected returns in either a positive or negative way.

As another example, an outcome may be foreseen, but assigned a low risk. If that event occurs, would the taxpayer’s pricing be respected?

As USCIB and other business commentators have repeatedly made clear, certainty in the application of transfer pricing and other taxation rules is of paramount importance. Businesses are concerned that regardless of how good their upfront analysis is, if there are significant deviations (outside the 80 -120 range suggested above) it will not be possible to prove that the projections were properly done and ex post results are attributable to unforeseeable events. One solution to this problem is for taxpayers to pursue APAs, particularly bilateral APAs; however, neither taxpayers nor governments have the resources to resolve all these issues through the APA process. A less burdensome idea that might merit consideration may be an “APA light”. The object of an “APA light” would not be to reach agreement on the pricing, but rather to submit the documentation that would be required for an APA such that the government could agree before the results are known by either the taxpayer or the government that the taxpayer’s analysis was sufficiently robust that it would not be subject to review under the HTVI rules. The government could of course still challenge the transfer pricing (since it was not agreed), but not on the basis of ex post results.

USCIB is also concerned about one-sided adjustments; if one jurisdiction is making an upward adjustment under these provisions, then it is important that the jurisdiction on the other side of
the transaction make a downward adjustment⁴. Thus, it is very important that the look-back aspect of the proposed guidance not extend too far back or correlative adjustments may be time barred. Further, if the taxpayer does include an arm’s length contingent payment clause in its contract, both upward and downward adjustments pursuant to that clause should be respected.

Finally, the proposals contained in the discussion draft represent significant changes from the current guidelines. They should, therefore, apply only prospectively; that is the proposals should only apply to transactions undertaken after the adoption of the proposals. This is especially important because a key aspect of the proposal relates to contemporaneous documentation of the transaction. Taxpayers cannot, in 2015, comply with changed requirements to contemporaneously document ex ante prices for transactions that took place long ago.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)

⁴ This is why it is important the proposals not be elective.