Quantera Global

To the OECD

Email: TransferPricing@oecd.org

Dear Sir, Madam,

Please find attached the comments of Quantera Global on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles.

Kind regards,

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Quantera Global

Comments on
The Revised Discussion Draft on
Transfer Pricing Aspects of Intangibles
By
Quantera Global

Quantera Global is pleased to provide its comments to the revised discussion draft.

We congratulate the OECD on the work done so far. The revised draft is a good step towards a more consistent transfer pricing treatment of intangibles and will assist both MNEs as tax authorities in evaluating the arm's length nature of the intangible related transactions.

We will provide some general comments first and then address specific issues following the order of the revised discussion draft and reference the relevant paragraph numbers of the draft where appropriate.

General observations.

Separate annex for examples

The use of multiple examples will provide practical guidance in cases that are likely to occur frequently in practice. The positioning of the examples in a separate annex however may cause the examples to be applied on a stand-alone basis which might result in too mechanical application without proper consideration of all guidance that is provided in the wording of the chapter. We therefore would like to recommend to include the examples in the main text where they provide for an illustration of the relevant paragraphs. Alternatively we would suggest to include more specific references to the relevant parts of the main text in the annex to allow easy reference of the specific examples to the relevant paragraphs of the chapter.

Practical application

Although the draft provides for some useful concepts that help to address the difficult issues related to intangibles we feel that there are some areas where additional guidance would be helpful on the practical implementation of these concepts. Especially where it is stated or assumed that comparability adjustments need to be made it more guidance would be welcomed. Although we appreciate the fact that each case will need to be evaluated on its own merits we do belief both MNEs and tax authorities would be helped significantly if some more practical guidance would be provided on how to adjust for certain differences like e.g. market differences. Some additional examples to illustrate could be helpful.

Terminology

The draft is clear in its choice for the interpretation of what may constitute an intangible. We do appreciate this approach as it allows full focus on the arm's length principle without having to cope with the heritage of established alternative definitions/interpretations applied in other disciplines like accounting or (IP) law. However we do feel that the wording of the draft may lead to some confusion due to the use of terminology. An example is the frequent reference to

the ‘legal owner’ of an intangible. The wording ‘legal owner’ has a specific meaning within the legal practice which may not be fully consistent with the intended meaning of the draft. The draft does seem to include a party which has only contractual rights to an intangible as a ‘legal owner’. Also a party is considered ‘legal owner’ based on the control functions performed and possibility to restrict the use by others. We suggest to consider using a terminology that reflects the exclusive use for transfer pricing purposes and avoids confusion that easily could result in disputes. An alternative could be to replace ‘legal owner’ by ‘TP owner’ and provide for a clear definition of the ‘TP owner’. If the wording ‘legal owner’ would be maintained still a clear definition for transfer pricing purposes would be welcomed. In addition the examples could include clarification on what party would be considered the ‘legal owner’ for transfer pricing purposes.

Specific comments

Paragraph 4 and 7:
The guidance in itself is clear: when one can identify comparable entities in the same market all market related circumstances will pose no comparability issue. However it should be avoided that this would be abused by tax authorities to mechanically demand the use of local comparable entities and thus substantially increase the compliance burden for MNEs. We would welcome some wording that would clarify that a party claiming the existence of special market circumstances would have to substantiate such claim in order to justify a demand for local comparable entities. In addition some guidance would be recommended on the acceptability of regional comparables.

Paragraph 5 and 8:
As indicated above under general comments the reference to comparability adjustments to account for market differences might be illustrated by some examples to provide practical guidance.

Paragraph 14:
When a workforce is deemed to be ‘unique’ it will be difficult to apply comparability adjustments to reflect the impact on product prices. Additional practical guidance would help avoid difficult disputes on this matter.

Paragraph 16:
It is indicated that ‘In many instances the transfer of individual employees…will not give rise to a need for compensation’ The words ‘many instances’ and ‘many cases’ seem to indicate that there are also a number of instances where such individual transfer or secondment would in fact result in a need for compensation. This could lead to discussions in respect of regular expat activities where highly skilled employees are regularly seconded abroad. We would suggest to give further guidance which could reflect the fact that a separate compensation would be necessary only in exceptional cases.

Paragraph 17:
The wording ‘result in the transfer…’ puts emphasis on the ultimate result regardless of the intention of the parties. This could result in tax authorities claiming a ‘know-how transfer’ in case of regular secondments. It would be helpful if more guidance/clarification could be provided (e.g. through an example) under what circumstances a know-how transfer would occur and would require a separate remuneration. In this respect it would also be helpful to consider the combination of a royalty payment for the use of know how under a license arrangement and the separate secondment of experts.

Paragraph 19 - 23:
It seems that a ‘deliberate concerted action’ is not seen as some sort of service between group companies. What in fact would constitute a ‘deliberate concerted action’ is not clear and may lead to disputes. The specific use of the word ‘structural’ triggers the question what would be considered structural. Does this indicate that when an advantage is realised only once or twice there is no ‘structural’ advantage and therefore no need to account for such benefit? The draft indicates that in case of material synergistic benefits a comparability adjustment would be appropriate. It is not clear whether/how comparability actually is an issue here. The further paragraphs however seem to indicate that in case of such concerted actions the resulting benefits would need to be divided among the relevant members of the group. This would more suggest the existence of a relevant (service) transaction between group members than only something that would lead to a comparability adjustment. We would appreciate some further clarification in this respect.

Paragraph 27 (example 2):
The example shows a benefit from the increased rating due to the parent guarantee. When looking at the guidance provided on central purchasing (paragraph 21 and example 3 -5) the question may rise to what extent the guarantee fee could/should be allocated to group companies that together provide the equity base that allows the Parent to provide the guarantee. Some further guidance would be helpful to address the practical allocation of the benefit.

Examples 3-5 (paragraphs 28-33):
The examples illustrate that when a benefit results solely from the combined volume such benefit should be allocated to the group members. In practice the added value of central purchasing departments may however involve much more than just adding volumes. The benefits established will be a result of a combination of volumes and specific expertise and know-how. We would like to suggest to add wording to the example to clarify that depending on the facts and circumstances of a specific case the purchasing activity might also result in high value added services that may require other remuneration methods than costs plus a mark-up. Furthermore the practical implementation of an adjustment as indicated in paragraph 33 may result in disputes. It would be helpful if also could be indicated what intercompany transaction would need to be adjusted for Country B. Would the counterparty to the transaction be country A or country C or country D?

Paragraph 34:
Here a specific reference to tax administrations is introduced compared to the previous wording. Although this might seem logical we fear this might result in more controversy. The previous wording allowed MNEs to apply 'other methods' if deemed appropriate and the tax administration could of course always audit and evaluate. The current wording introduces an option to tax authorities to impute other methods when auditing the transactions of the MNE years after the facts. This could result in situations where MNEs may find less comfort in applying the OECD methods as they may be confronted by tax authorities disregarding the OECD methods and imposing other methods whenever they deem this appropriate. This might increase the level of uncertainty for MNEs. We therefore would like to suggest to add wording to clarify that tax administrations should only apply other methods retrospectively in exceptional cases where the use of OECD-recognized methods clearly would not be appropriate.

Paragraph 36:
It is stated that other items or activities may also convey economic value and should be taken into account even if they are not referenced in chapter VI. Given the broad scope of chapter VI it is not clear what exactly might be addressed here. Especially as goodwill is specifically addressed as part of chapter VI and likely will absorb other value drivers. The current wording might result in statements/claims about value added items and/or activities even if they would not be recognized under chapter VI. This could limit the current effort to come to a common understanding on intangibles and minimize uncertainties. We therefore suggest to further clarify and restrict the wording of paragraph 36 so that it cannot be used to circumvent the results of the guidance of chapter VI. When certain value drivers would be identified that would not fall under the scope of chapter VI it is important that both MNEs and tax authorities have a reasonable common understanding how to deal with them for transfer pricing purposes.

Paragraph 43:
There is specific reference to a 'single enterprise' but it is not clear whether this is actually a strict condition. In practice it can occur that certain activities/items are controlled by a coordinated group of entities where each individual entity may not have sufficient control. We understand that the focus here would be on the word 'capable' indicating that it would not be determinative whether de facto all control would be within one entity or spread among a group of cooperating entities as long as it could be possible for a single entity to have full control. We suggest to delete here the word "single".

Paragraph 51:
We suggest to amend the wording to "… (i) that are not comparable to intangibles used by or available to **other** parties…" to better reflect that in case of internal comparable transactions the tested party obviously does have access to the exact same intangible. Also the words 'greater…benefits' would similarly apply to the use of a routine intangible when the use of the intangible is still needed for the business but easily substitutable. Maybe it could be indicated that a 'unique

and valuable' intangible would be expected to yield '**substantially** greater benefits'

Paragraph 59:
The recognition of a license as a separate intangible should not in itself lead to a conclusion that both parties (licensor and licensee) own unique and valuable intangibles which would require the use of a profit split method.

Paragraph 61:
Goodwill and ongoing concern value are considered to represent intangibles within the meaning of section A.1. This could be interpreted as 'assets', but special ones that cannot be transferred in isolation (as confirmed in paragraph 60). We would appreciate some more clarification how this would interact with the guidance in paragraph 9.90 of the Guidelines where a conversion from a full risk distributor to a limited risk distributor could result in a transfer of an intangible.

Paragraph 67:
We suggest to clarify that legal rights and contractual arrangements form the starting point for any TP analysis, not just the ones involving intangibles.

Paragraph 68:
The reference to the 'registered legal owner' seems not to cover the full picture? Based on paragraph 67 the 'legal rights and contractual arrangements' are the starting point. This would indicate that contractual rights also determine the claim on the use of the intangible. The reference to 'legal owner' may proof to be confusing as the common understanding would connect this with legal registrations only and not with contractual rights. We also refer to our general comments that suggest to consider the use of a distinct terminology that would avoid or limit misinterpretations due to already established definitions in other practice areas like (IP) law.

Paragraph 71:
The use of the term 'legal owner' seems to differ from a strict legal interpretation. If we understand the wording correctly the 'legal owner' would also include a party that has a contractual right to the intangible. Further it is expressed that even a party with no legal or contractual rights may be identified to be the 'legal owner' for transfer pricing purposes. We feel that the use of a commonly used legal term but with what seems a different reference may facilitate confusion and should be avoided.
We also refer to our general comments that suggest to consider the use of a distinct terminology that would avoid or limit misinterpretations due to already established definitions in other practice areas like (IP) law.

Paragraph 73:
It is suggested that the 'legal owner' should remunerate the group members involved in the intangible. This indicates that a separate transaction between the 'legal owner' and the other group members is assumed. It is not clear what

transactions are assumed to take place between the group members and the 'legal owner'. Further guidance and clarification on this issue would be helpful.

Paragraph 76 -77:
If a legal owner would be entitled to the intangible related return it would need to either perform or control the performance of the relevant functions. Outsourcing of certain functions is allowed. A question would be whether all functions related to the intangible could be outsourced by the legal owner. If a legal owner would contract a third party to manage and supervise the relevant functions and coordinate/control the functions of other group companies involved in the intangible would this still justify the allocation of intangible related return to the legal owner? All activities are outsourced but to different contractors and the question could be raised if the legal owner would be able to exercise control over group companies executing some of the relevant functions by means of a third party contractor. Paragraph 80 seems to indicate that the legal owner in such case would not retain the intangible related returns. However when a third party would be contracted to act on behalf of the legal owner would this make a difference? In other words: does it make a difference whether the legal owner would perform functions through its own personnel or through the involvement of a third party service provider?

Paragraph 90 -91:
The group members that perform the relevant functions and contribute to the intangible value should receive the relevant part of the intangible return. We belief some examples would be helpful to clarify and illustrate the transactions that would be identified to take place in order to actually allocate the proper income to all parties involved. Would it also call for deemed transactions?

Paragraph 163 -164:
It may be confusing that at first the CUP method is identified as one of the methods most likely to prove useful and next it is stated that it is difficult or even impossible to find reliable comparable transactions to be able to apply a CUP.

Paragraph 170:
We agree with the statement that it should not be assumed that all of the residual profit after functional returns would necessarily be allocated to the licensor/transferor. However it would be helpful if some further guidance and/or examples could be provided to illustrate alternative allocations.

Paragraph 205:
The concept of adjustment clauses or renegotiations is clear.. It is however less obvious how it could be determined when third parties would apply an adjustment clause. Or would renegotiate. It would be helpful if more guidance could be included, as to how to identify relevant third party behaviour. Also it would be helpful if the guidance could indicate what party would be expected to provide substantiation of its position.