

Comments Concerning the Special Considerations for Intangibles

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This analysis reviews the OECD's Revised Discussion Draft pertaining to the Transfer Pricing Aspects of Intangibles issued on July 30, 2013. This draft, when promulgated, would substantially revise Chapter VI of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations promulgated on July 22, 2010. The discussion draft would replace Paragraphs 6.1 through 6.39 with Paragraphs 35 through Paragraphs 223, plus examples. The material under review is the second redraft of intangibles principles; the OECD issued the first redraft on 2012.

Primary Objection to the Second Redraft

It is our view that the drafters of the second redraft focus primarily on a multinational enterprise having intangibles that would be subject to a particular tax administration. As such, the drafters of the second redraft fail to address the needs of a multinational enterprise being subject to more than one tax administration. While we are mindful of the OECD's and G20's pressure against Base Erosion and Profit Shifting, a goal which we fully support, we also recognize that a multinational enterprise might be subject to double taxation.

Such double taxation can arise because multiple tax administrations might view the incidence of taxation differently because of the circumstances of the intangible involved. It is our view that tax administrations are likely to impose intangible tax policies that meet their own needs, and that tax policies of each tax administration might differ and be conflictive, causing this second redraft failing to meet this primary tax objective.

In addition to our primary objection to the second redraft, we have specific objections to specific paragraphs within the second redraft.

Functions, assets, and risks related to intangibles

Paragraph 79 provides that, in considering the prices to be paid for functional contributions and the allocation of returns attributable to intangibles among members of the MNE group, "certain important functions will have special significance." Paragraph 79 enumerates "these more important functions." However, this list of these more important functions fails to include the financial review of marketing functions, including a rate of return analysis of these functions and financial capacity. In our view, these financial marketing functions would have special significance.

Research, development and process improvement arrangements

Paragraph 97 provides that “appropriate compensation for research services will depend on all the facts and circumstances, such as whether the research team possesses unique skills and experiences relevant to the research, bears risks (e.g. where “blue ski” research is undertaken), uses its own intangibles, or is controlled and managed by another party. “ We agree that the drafters pertaining to paragraph 97 provide a viable standard for providing research services. However, the following sentence pertaining to “a modest markup” creates ambiguities rather than resolving them: “Compensation based on a reimbursement of cost plus a modest mark-up will not reflect the anticipated value of or the arm’s length price for the contributions of the research term in all cases.” We suggest the language be restated as follows: “appropriate compensation for research services will depend on all the facts and circumstances. Factors such as whether the research team possesses unique skills and experiences relevant to the research, bears risks (e.g. where “blue ski” research is undertaken), uses its own intangibles, or is controlled and managed by another party preclude the compensation of these services as being modest.”

Payments for the use of the company name

Paragraph 99 provides that, “as a general rule, no payment should be recognized for transfer pricing purposes for simple recognition of group membership or the use of the group name merely to reflect the fact of group membership.” We view the phrase “simple recognition of group membership” as ambiguous. The membership might, or might not, create substantial value depending on the circumstances.

Paragraph 100, referring to a payment for use in an arm’s length transaction, reaches a legal determination, that “such payments may be appropriate where a group member owns goodwill in respect of the business represented by unregistered trademark, use of that trademark by another party would constitute misrepresentation, and the use of the trademark provides a clear financial benefit to a group member other than that owning of the goodwill and unregistered trademark.” It is our view that the term “constitute misrepresentation” is a legal construct that should have no connection with transfer pricing.

Paragraph 102 would preclude the automatic assumption that a payment should be made “where an existing successful business is acquired by another successful business, and the acquired business begins to use a name, trademark or other branding indicative of the acquiring business.” It is our view the automatic assumption of payment is appropriate when the trade name is already known in that jurisdiction.

Transfers of intangibles or rights to intangibles in combination with other business transactions

Paragraph 117 uses the term “package contract” but fails to define that term: “In these situations, the price of the package contract should be disaggregated in order to confirm that each element of the transaction is consistent with the arm’s length principle.” It addition, the

contract should be disaggregated, not the price of the contract, contrary to the present phraseology.

Paragraph 118 uses the derogatory “so-called” terminology pertaining to a business franchise arrangement: “One situation where transactions involving transfers of intangibles or rights in intangibles may be combined with other transactions involves a so-called business franchise arrangement.” It is our view that the terminology should eliminate the phrase “so-called.”

Transactions involving the use of intangibles in connection with sales of goods or provision of services

Paragraph 122 would have the transferor “clearly specify” the nature of the transaction where there is no transfer of the intangible or the rights to the intangible. It is our view that the drafters should provide examples that would illustrate the nature of these “clearly specified” activities.

Supplemental guidance for determining arm’s length conditions in cases Involving intangibles

Paragraph 125 provides that, “in particular, the recommended nine-step process set out in paragraph 3.4 can be helpful in identifying arm’s length conditions for transactions involving intangibles.” It is our view that the above-mentioned reference to paragraph 3.4 overstates the importance of paragraph 3.4, which was a “typical process,” and is not compulsory. It is our view that the drafters to paragraph 125 should restate the fact that the nine step process is typical and is not mandatory.

Supplemental guidance on transfer pricing methods in matters involving the transfer of intangibles or rights in intangibles

Paragraph 160 would eschew the cost method in its entirety as a means of valuing intangible development: “There rarely is any correlation between the cost of developing intangibles and their value or transfer price once developed. Hence, transfer pricing methods based on the cost of intangible development should usually be avoided.” As transfer pricing practitioners, we question the drafter’s assertions. In addition, it our view that cost is a viable factor, and perhaps the only factor, for matters involving small and mid-sized transfers of intangibles or rights in intangibles.

Determining arm’s length prices for transactions involving the use of intangibles in connection with the sale of goods or the provision of services

Paragraph 219 specifies, but fails to elaborate on various newly-created comparability adjustments – i.e., differences in markets, locational advantages, business strategies, assembled workforce, corporate synergies, and other similar factors. It is our view that the drafters need to provide examples as to how these comparability adjustments are to work.