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Dear Mr. Andrus:

We appreciate the opportunity given by the Working Party No. 6 of the Committee on Fiscal Affairs to comment on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles. Below you will find our comments:

Comments on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles

Intercompany transactions which involve the disposal of intangibles require the scrutiny of several specific items which can lead to determine if the transaction under analysis generates an economic value and if that value can be attributable to the possession of the intangible. Our experience and comments with respect to the subject are summarized below.

a Identifying intangibles

As of the categories of intangibles observed in the document, OECD provides several examples including: Patents, Know-how and trade secrets, Trademarks, Trade names, Brands, Licenses, Goodwill, Group synergies, among others.

We consider that the definition of Goodwill provided in the document can be ambiguous as the different tax jurisdictions may have particular classifications of this concept that may not concur among them. As for the valuation of a Company's Goodwill when a transaction of sale of an intangible occurs or when a business valuation of a Corporation is conducted, we strongly recommend that the OECD provide an example of the most suitable methodology or an approach to calculate the value of this concept.

In our view, labor relations or business contacts and distribution channels are significant intangibles which are not included in the document and that should be considered by the OECD. This, because the mentioned concepts can substantially modify the pricing of the product or the service rendered by a company.

b Determining Arm's Length Conditions in Cases Involving Intangibles

While the document provides some guidance to avoid certain assumptions or misusages commonly practiced in the determination of an Arm's Length transaction that involves intangibles, it does not offer any specific advice or assessment that could lead into a method to estimate the value of an intangible, which could be considered as acceptable according to the OECD standards. In our point of view, OECD should include examples in which the application of financial valuation methods are applied and how it would be related to the use of the Transfer Pricing Methods and also to share resolutions of cases that might have arisen with tax authorities as examples. Additionally, concerning proper valuation techniques, OECD may also specify applicable discount rates when determining values of projected cash flows.

1 Transfer Pricing Methods

When applying the Comparable Uncontrolled Price Method, the document and the OECD Transfer Pricing Guidelines establish that the information used in an analysis conducted with the aforementioned method, should be comparable enough to the specific circumstances of a controlled transaction and if it is the case in which differences exist, they should be reasonably adjusted. Despite this fact, in cases involving intangibles, comparability between controlled and uncontrolled transactions may not be easily improved through reasonable adjustments, since it could involve variables or conditions whose effects on the transaction could not be properly determined or adjusted. In our view, OECD should extend its definition of reasonability or even provide examples of which adjustments could be considered as reasonable.

The document also states that the Residual Profit Split Method should be considered as an option to reliably analyze transactions involving intangibles. Although we agree with this point of view, we also believe that the application of this method may not provide the best conclusions. In our opinion, the application of this method is possible only when there are two parties involved and the functions assumed in the transaction, correspond to the core business of each company. The accurateness of the results obtained with this method are diminished when the transaction involves more than two parties or when the parties engaged have more than one principal business activity. In this case, the assignment of the operating income attributable to each one of the parties may not be properly assigned as the functions performed by each party could not be specifically outlined.

Despite the document mentions the application of the Comparable Uncontrolled Price Method and the Residual Profit Split Method for the evaluation of intangibles, it does not specify the criterion of practical application through the existence of hypothetical examples. In our view, OECD should include practical cases in which the Transfer Pricing Methods are applied to evaluate intangibles, in addition to the criteria of the scope of the application of comparability adjustments. Also, the hypothetical adjustments mentioned should apply to real conditions, according to the different intangible types defined in the document.

In addition, the application of the Residual Profit Split Method is suitable in the case that only one of the parties involved is the owner of a unique intangible; however, in the case in which both parties own intangibles, this method loses strength since it would not be possible to assign an specific value for each of them.

An important issue regarding Transfer Pricing methodology arises when valuation techniques are used in intercompany transactions involving intangibles. The main inconvenience is that, according to our experience, none of the valuation techniques can be paired up to any of the Transfer Pricing methods set forth in the OECD Transfer Pricing Guidelines. Another difficulty is that legislation in some countries is very strict and clear and taxpayers must adhere to a Transfer Pricing methodology. In this regard, our comment is that OECD must provide guidance on identifying which of the different valuation techniques correspond to each one of the Transfer Pricing methods, or, on the other hand, it must specify if there is no parameter to establish any type of association between them.

2 Assumptions and Parameters

Given its importance on different valuation techniques, the document states that the assumptions and parameters taken into account should be reasonable and that taxpayers and tax administrations should describe the basis for its selection. However, since it does not specify some guidance, in our opinion, OECD should detail what can be considered as a reasonable assumption or parameter.

In our opinion, OECD should give more detail when the term "Valuation performed for accounting purposes" is mentioned, since different interpretations may arise for the main purpose of the valuation itself, the moment in which it is performed or if it is different from a valuation for transfer pricing purposes.

3 Discount and Growth Rates

According to the document, caution should be taken into account when the valuation models contain or use linear growth rates. Regarding this subject, we recommend that the OECD provide some elements that should be taken into consideration in order to determine a reliable growth rate which could be used in the application of the different valuation techniques.

The document also states that neither taxpayers nor tax authorities should assume that a discount rate based on a Weighted Average Cost of Capital (WACC) approach should always be used in the analysis. In our view, OECD should stipulate or provide examples of when this WACC shall not be considered as the best approach and some other options should be taken into account.

4 Forms of Payments

In our view, a distinction between the risk of carrying out the transaction and the financing cost over time should be explicitly declared. The importance of this situation is that the first concept considers the risk that the parties bear even though the transaction is conducted or not. It is worth mentioning, that in our opinion, this risk is reflected on the discount rate applied on the valuation models. On the other hand, the financing cost over time ought to include the opportunity cost of both parties considering the money value over time, which means a different concept than the first mentioned.

Moreover, taxpayers have disadvantages when, in the case of an audit, tax authorities own updated information that did not exist at the moment in which the valuation was prepared. The existence of these two different moments could result in the assumption by the Tax Authority that the taxpayer intended to take an advantage, which is not necessarily correct. Thus, in our view, OECD should point out this situation and mention that a valuation is valid if the taxpayer owns the supporting documentation of its arguments.

We want to express our gratitude for the opportunity to express our comments and hope that our observations will help move both Drafts forward.

Sincerely,

Ricardo Suárez David

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