

Private and Confidential

Organisation for Economic Co-operation and Development (OECD)
Attn. Mr. Jeffrey Owens
OECD 2, rue André Pascal
F-75775 Paris Cedex 16
France

14 September 2010

Dear Mr. Owens,

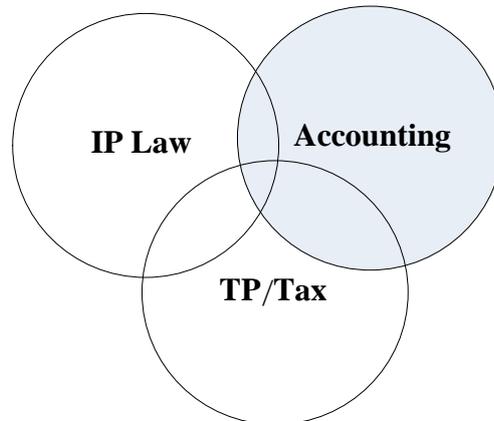
Transfer Pricing Associates (hereinafter referred to as TPA) is pleased to accept OECDs invitation to share our views on the scheduled update of Chapters VI and VIII of the OECD Guidelines on Transfer Pricing for Multinational Enterprises and Tax Administrations (hereinafter referred to as ‘TPG’ or ‘The Guidelines’).

After an introduction, TPA will be addressing:

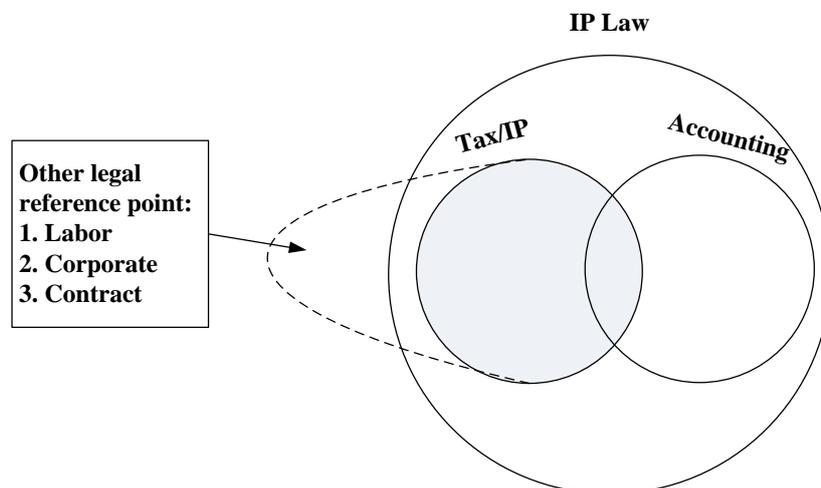
- a) the most significant issues encountered in practice in relation to the transfer pricing aspects of intangibles;
- b) what shortfalls, if any, they identify in the existing OECD Guidance;
- c) what the areas are in which they believe the OECD could usefully do further work;
- d) what they believe the format of the final output of the OECD work should be.

Introduction/labels of intangibles

1. TPA suggests the OECD to leverage from existing fields of expertise like IP law and Accounting Standards in defining intangibles.
2. According to TPA two approaches may be considered to put the scoping exercise currently performed by the OECD in the relevant context. These approaches try to capture the relationship between (i) intangibles definitions for IP law (ii) intangibles definitions for Accounting Standards and (iii) intangibles definitions for Tax/Transfer pricing purposes.
3. Approach I assumes the intangible definitions used in each of the three fields of expertise have a relative limited overlap. This can be illustrated through the following chart:



4. Approach I has an advantage that it creates flexibility for the new generation of intangibles, e.g. embedded workforce, supply intangibles, supply-demand management intangibles, while it requires OECD to provide an extensive set of references and definitions – including an extensive definition of economic ownership – since it can only leverage from the IP law and Accounting Standard definitions in a limited manner.
5. Approach II assumes the intangible definitions used in each of the three fields of expertise have a large overlap. This can be illustrated through the following chart:



6. Approach II has the advantage that it creates a solid reference for the majority of the intangibles to IP law as well as that the other minority of intangibles – i.e. typically the categories of exotic or so called soft intangibles – is still protectable through contract law, corporate law, labor law etc. A disadvantage is that IP law is not always following all new appearances of intangibles, i.e. static versus a dynamic approach. In addition, anti-trust legislation will restrict any major extensions of the intangibles definition under IP law. Legislators will try to balance the interest of an investor to be

able to have some time to – in a protected manner – earn back its investment versus the common interest of consumers in a full competitive market place.

7. Approach I could be applicable to the software industry where copyright protects the source code of newly developed software (and all other software related intangibles are typically not protected), whereas approach II would be applicable to the pharmaceutical industry where the heavy R&D investments are protected through patents utilizing IP law to the fullest.
8. The preference of approach I versus II will vary per industry, which makes a selection for one prevailing approach by OECD not necessarily a wise approach.

Most significant issues encountered in practice

9. TPA suggests to provide a relevant list of characteristics which make it possible to identify intangibles, like (i) economic lifetime (ii) layers of legal protection (iii) a recognized market premium etc, all leading to a sustainable residual profit attributable to the intangibles.
10. TPA would like to request more guidance on the relationship between legal and economic ownership, especially in case under a cost contribution arrangement one legal owner and multiple economic owners have to share the joined benefits. Also recent discussion on the situs of intangibles (location of origination) might have to be addressed. The sometimes opportunistic views of tax authorities on what is the prevailing ownership definition (legal versus economic) leads often to conflicting views between tax authorities and a high probability of double taxation.
11. TPA urges the OECD to consider specific guidance on the OECD accepted transfer pricing valuation method, e.g. discounted cash-flow (DCF) method and the multiplier method. This would allow a more structured discussion, whereas today most tax authorities do not feel comfortable to address DCF and/or multiplier as a OECD authorized methodology.

Shortfalls in the existing OECD Guidance

12. TPA would like the OECD to consider leaving multinational enterprises taking a flexible attitude towards the application of approach I or II as outlined under the introduction.
13. OECD should consider introducing three new categories of intangibles, being (i) product related intangibles (ii) process related intangibles and (iii) marketing related intangibles. A list illustrating such a classification is attached as Appendix I. These would replace the existing classification used by OECD between trade and marketing intangibles.
14. TPA should give extensive guidance on the selection of the most appropriate method for valuation of intangibles, where besides leverage from the existing valuation practice, examples on the application should be provided as an illustration.

15. OECD is requested to make a clear distinction between OECD authorized valuation methods for a 'going concern' versus an isolated 'intangible'.

Areas for further work

16. TPA would like the OECD to consider a clear intangibles definitions relevant for chapter IX TPG relating to business restructurings, including some guidance in case the intangibles are only an insignificant portion of the business being restructured and transferred between Group companies.
17. TPA recommends the OECD to make a clear distinction between (i) valuation methods for 'going concern' versus (ii) valuation methods for 'intangibles'.
18. OECD is requested to consider further work in the application of external databases to quantify the level of (i) royalty rates (ii) multiplier market references (iii) other sources to enable the valuation of intangibles.
19. TPA strongly suggests defining the boundaries of intangible definitions, e.g. not all exotic value drivers can be classified as an intangible. Example: on an explicit base exclude 'location savings' from doing business to be classified as an intangible

Format of final OECD output

20. TPA suggests OECD to provide the following guidance (i) on classification and definitions of labels used for intangibles (ii) on identification criteria for intangibles (iii) regarding the prevailing concept of ownership, including a clear guidance on multiple ownership positions (iv) relating to acceptable valuation methods and practical guidance for their application.
21. TPA recommends leveraging from existing fields of expertise like IP law and Accounting Standards to avoid an isolated – and most likely confusing - approach for tax/transfer pricing purposes.
22. OECD is requested to provide clear scoping, timelines and deliverables for its workplan on intangibles, given the extreme impact of the OECD analysis on the application of transfer pricing rules and guidelines in practice, i.e. the intangibles typically reflect between 60% to 80% of a multinational enterprises value chain and requires a clear, concise and practical set of guidelines provided by the OECD.

Although the above is only addressing the OECD scoping exercise, the work to be performed is of the utmost importance to all parties involved. TPA congratulates the OECD with its initiative, but also encourages and urges the OECD to provide clear guidance within a reasonable period of time to both the tax administrations as well as the multinational enterprises. A further delay will potentially create unprecedented levels of controversy between taxpayer and tax authorities or between tax authorities.

TPA and its alliance partners will be pleased to contribute to the further development of updated chapters VI, VIII and IX on intangibles.

Yours sincerely,

On behalf of TPA and alliance partners

Steeff Huibregtse

OECD IP project: Illustrative labelling of intangibles

14 September 2010

Product related intangibles	Process related intangibles	Market and Marketing intangibles	Hybrids
<ul style="list-style-type: none"> • Patent • Invention • Pattern • Methods • Copyright • Design / Model • Formulae/Recipes • Software • Literary, musical, or artistic composition / film • Technical data / documentation • Prescription drug files • Library • Natural resources • Database • Permit • Regulatory license e.g. from central bank • Trade secrets 	<ul style="list-style-type: none"> • Know-how • Software • Method • Procedure • System • Supplier relationships • Procedural manuals • Technical data / documentation • Training manuals • Managerial skills and core competencies • Airport gates and slots • Financial instruments • Embedded work force • Supply chain intelligence 	<ul style="list-style-type: none"> • Logo • Trade mark • Trade name • Brand • Campaign • Survey • Customer list • Import quota • Customer relationships • Distribution network & agreements • Retail shelf space • Subscription lists • Publications/thought leadership • Reputation • Book of business 	<ul style="list-style-type: none"> • Franchise • Permit / right / license (air, water, land, drilling, emission, broadcasting) • Domain name • Unique location