Under what circumstances, if any, should an entity other than the legal title holder be entitled to intangible related returns?

- Whether the current legal title holder is the *bona fide* owner is a question of law
- Whether an entity other than the legal title holder is an owner is a question of law
- Intangible related returns and premium returns
  - Character of revenue
  - Ownership → risk → expected return to enterprise
- An entity is not a PE (*i.e.* a person that can enter into a contract)
- 'Return' to entity other than legal owner should be compensation perhaps taking the form of a charge for high-value services or a payment resulting from a profit split
- Consider how unrelated parties would settle a dispute "after the fact"
Under what circumstances, if any, should an entity other than the legal title holder be entitled to intangible related returns?

- Look to legal precedent to determine cause, form and terms of settlement (i.e. patent infringement rulings)
- Economic principles inform legal principles, country legislation and country case law
- OECD principles cannot contravene country law
- 'Economic ownership'
  - Paid to invent and develop an asset
  - Earns the right to use the asset
  - Can prevent others from using the asset or claiming title

What role should related party contractual arrangements have in this determination?

- Related party agreements should not be ignored
- Agreements usually disclose identity of legal owner(s) of intangibles
- Agreements document the intent of parties
  - setting of expectations
  - set transaction terms and conditions relative to known industry norm
  - establish factors influencing expected return
- Realize that many courts look past an agreement to the actions of the parties
  - Did the related parties follow the agreement?
What role should related party contractual arrangements have in this determination?

- Is a requirement to write an agreement any more onerous than the requirement to prepare documentation for transaction?
- Would the increase presence of intercompany agreements reduce controversy over facts, considering verification is still needed?
- Agreements help us do comparability adjustments
- Danger is that absence of a third party comparable agreement/circumstances will lead to recharacterization
- Tax authorities must be encouraged to avoid asserting that arm’s length parties would not behave this way without proof
  - Not consistent with TPG para 9.19

To what extent can guidance analogous to paragraphs 9.10-9.38 be useful in resolving uncertainty over the allocation of the right to premium returns associated with intangibles for transfer pricing purposes?

- **9.10 Market concept of increased risk, increased return**
  - Ownership of valuable intangibles should entitle one to higher expected returns
  - If risk or intangible not economically significant → bearing risk or having ownership of the intangible would not have significant effect on profitability or right to higher expected return

- **9.11-9.17 Contractual Terms**
  - Contractual agreements help determine ownership, risks borne
  - Need to consider if conduct of parties conforms to the contractual agreement regarding ownership of IP (are functions performed and risks borne consistent with the agreement)
To what extent can guidance analogous to paragraphs 9.10-9.38 be useful in resolving uncertainty over the allocation of the right to premium returns associated with intangibles for transfer pricing purposes?

• 9.11-9.17 Contractual Terms – Cont.
  - Is contractual ownership consistent with parties contribution to/control of the intangibles
  - Is contractual arrangement arm's length? → would arm's length parties in the industry agree to similar arrangements

• 9.17-9.21 Role of Comparables
  - Helpful in identifying evidence of comparable terms, form of remuneration, and profit potential of parties
  - IP sale may be more contentious → consider separate section regarding valuation criteria, methods to consider

• 9.29-9.36 Financial Capacity
  - Greater financial risk is consistent with expectation of higher returns
  - IP owner should bear cost of managing/mitigating risks to protect intangibles
  - IP owner should have capacity to bear costs that may arise as result of challenge (e.g. patent infringement)
  - IP owner should have sufficient financial resources to fund the cost of development and maintenance of the intangible asset
To what extent can guidance analogous to paragraphs 9.22-9.28 (Control Over Risk) be useful in resolving uncertainty over the allocation of the right to premium returns associated with intangibles for transfer pricing purposes?

• **Meaning of "Control"**
  - Capacity to make decisions to take on risk and decision on whether and how to manage the risk (may be internal or outsourced to external service provider)
  - Generally requires company to have people → employees or directors who have authority to, and effectively do, perform control functions
  - Not necessary to perform day to day monitoring & admin functions to control risk

• **Risk allocated to a party that has relatively little control**
  - Tax administration may challenge the arm’s length nature of such risk allocation (may be analogous to IP ownership)

To what extent can guidance analogous to paragraphs 9.22-9.28 (Control Over Risk) be useful in resolving uncertainty over the allocation of the right to premium returns associated with intangibles for transfer pricing purposes?

• **Locating economic substance and ownership of intangibles:**
  - Where IP is generated, who controls it, where control is located

• **Intangibles (Control)**
  - Which entity is controlling vs. contributing to, or assisting with, the development of intangibles
  - Location of key employees who strategically manage the different phases of developing, maintaining and protecting the intangibles
  - Need to consider criteria/qualifications to strategically manage as well as related responsibilities

• **Level of control depends on nature of risk, importance of intangible to an enterprise**
To what extent can guidance analogous to paragraphs 9.22-9.28 (Control Over Risk) be useful in resolving uncertainty over the allocation of the right to premium returns associated with intangibles for transfer pricing purposes?

- **Risks and Ownership (example, paragraph 9.26)**
  - *Principal* bears risk of failure and will be owner of outcome of research in case of success, provides strategic direction and evaluates project progress → entitled to *entrepreneurial profits*
  - *Contract Researcher* bears no risk of success or failure, no right in ownership, incurs own operational risk → allocated *guaranteed remuneration*

- **Entity other than legal owner controlling IP development**
  - Look to arm's length arrangements for guidance on division of revenue or profit
  - High-value services, Residual Profit Split