

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

September 14, 2010

Subject: Comments on Chapters VI and VIII of the OECD TP Guidelines

Dear Mr. Owens,

Altus Alliance (hereinafter referred to as Altus) is pleased to comment 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").

Altus 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 and what the areas are in which they believe the OECD could usefully do further work; and,
- c. What they believe the format of the final output of the OECD work should be.

These topics are discussed in the next paragraphs.

Most significant issues encountered in practice

1. Lack of adequate guidance to deal with cases in which a company owns a non-routine intangible that allows the company to generate an economic rent, i.e., a source of exceptional profitability relative to other firms in the same industrial sector. There is little guidance on an appropriate method to quantify an arm's-length return of an exceptional or non-routine intangible asset, but the more

significant problem in practice is that no criteria are provided that can be used to identify and differentiate such exceptional assets from more routine intangible assets.

The Guidelines fail to recognize that there are a wide variety of dimensions or qualities that may contribute to the value of a non-routine intangible asset. For example, the discussion of intangible assets in chapter VI is limited and only addresses the distinction between marketing and trade intangibles. Altus believes the commentary in chapter VI should be expanded to address other relevant dimensions that may contribute to the value of non-routine intangible assets such as identifiable / non identifiable, protected / non protected, indefinite life / finite life and unique / routine and the nature of legal remedies available for infringement. Additional guidance should be introduced that includes other characteristics that may contribute to the value of non-routine intangible assets.

2. Lack of guidance on arm's-length consideration for **centralised know-how**. It is becoming very common for companies to have developed centralised know-how, i.e., company specific knowledge that has been developed internally that provides a material economic advantage such as cost savings. In addition to well recognized intangibles such as trademarks and patents, centralised know-how can be a valuable asset for a company. For example, centralised innovation can provide a company the ability to distribute innovation throughout the company more rapidly and at lower cost than its competitors. There is little recognition in the Guidelines on the value of centralised know how and no direction on a method to address this issue.
3. Lack of guidance on arm's-length consideration for **ongoing know how**. Many companies develop ongoing know how from the expertise obtained from continued performance of activities such as R&D or product development. While ongoing know how contributes to the continued success of many companies, it is inherently difficult to identify the link between ongoing know how and enhanced profitability or revenue growth. In cases where a royalty is paid for such ongoing know how, tax authorities are more likely to challenge such a fee because of the difficulty in demonstrating the economic value, the dearth of information on third-party fees for such know-how and the lack of authoritative guidance. Additional guidance that recognizes the value of ongoing know how and provides direction on an acceptable transfer pricing method would be useful.
4. **Lack of guidance to distinguish a service from know-how**. In many cases contracts for transactions involving a transfer of intangible property also containing provisions on related service elements. In these contracts, it can be very difficult to determine how the consideration in the contract relates to the transfer or licensing of property as opposed to the performance of services¹. There is little in the way of guidance or examples that indicates how to differentiate between performance of a service and provision of know how. Additional guidance that provides a basis to differentiate the provision of

¹ TPG paragraph 7.3

know how or other form of intangible property from the performance of a routine service would be useful.

5. **Loss making entities and consistent TP approaches** – Although a consistent approach is generally required for transfer pricing of intangibles, tax authorities often challenge cases where a royalty is charged when an entity is loss making. Addition guidance to clarify when and if a royalty charge to loss making entities would be allowed would be useful.
6. **Valuation guidelines** - The lack of clear valuation guidelines can lead to subjective criteria by both taxpayers and tax administrations. In several countries such as Ecuador, Colombia, Mexico and Brazil this lack of precision has drawn academic criticism and raised the issue of unconstitutionality, based on the principle of legality.²

Shortfalls in the existing OECD Guidance and Areas for further work

1. A key issue is the need for a clear **definition of intangible property**.
 - Chapter VI introduces the term “**commercial intangible**”, but it is unclear how the term commercial applies in this case and what assets are included in commercial intangibles and what are excluded. Does the term commercial intangibles imply there also non-commercial intangibles? If so, what are non-commercial intangibles? We believe the term commercial intangibles is inherently ambiguous and requires further clarification.
 - As noted above, intangibles assets have various **dimensions** such as identifiable / non identifiable, marketing / trade, protected / non protected, indefinite lifetime / finite lifetime, unique / routine, etc. For transfer pricing purposes, the OECD guidelines should include these qualities and address the degree each of these dimensions are relevant.
 - Intangible assets are defined and discussed in various fields, including the legal, accounting and economics fields. Rather than attempting to reconcile these approaches and attempt to identify the similarities and differences in these disparate definitions, Altus believes the OECD should develop an **independent definition** of intangible assets developed explicitly for use in transfer pricing.
2. **Economic Perspective Required**. Furthermore, to the extent that transfer pricing policy seeks to apply a benchmark based upon the behavior of independent firms operating on an arm’s-length basis, Altus believes the definition of intangible assets must be based on an **economic perspective** in order to address the complications in defining and measuring the scope and value of intangible assets as discussed above.

² See also “Transfer Pricing: What The Experts Say It Is” by Daniel Rybnik, IBFD ITPJ, 2-2010

3. **Potential conflicts** – In cases where conflicts arise in national and international laws with respect to the definition or identification of intangibles for transfer pricing purposes, regulations or accounting standards, guidelines on how to approach these conflicts should be provided.
4. **Valuation of intangibles** – The OECD does not have extensive expertise or a history of dealing with techniques or methodology for valuation of intangible assets. Altus believes the OECD should avoid seeking to offer detailed valuation guidelines on intangible assets for transfer pricing purposes. Rather, the OECD should provide high level valuation guidance and rely on guidance issued by valuation authorities rather than providing detailed directives to cover valuation methods, issues and approaches.

Even though valuation techniques rely on mathematical formulas, the selection of the variables is dependent on judgement, and therefore valid conclusions can ultimately be reached only if the premises used are truth.

Safe harbour provisions in the field of intangibles valuation would be useful to provide some find of certainty to taxpayers and tax administrations in order to decrease risk exposure, lengthy disputes and documentation burden.

5. Bridge with **Business restructuring** chapter IX – Chapter VI and chapter VI address many issues also covered in chapter IX but these are important considerations that apply to the case of intangible assets inside the context of business restructurings as opposed to the use of intangible assets in ongoing business activity. Altus believes that a distinction should be introduced to clarify the difference between intangible assets used in general business and intangible assets used in the context of business restructurings.

Format of final OECD output

1. **Valuation of intangibles** - Altus recommends that the OECD should add another chapter to the TPG related to valuation of intangibles – due to the scope of this important topic Altus believes that a separate chapter is justified.
2. **Recognition of transactions** - Altus believes that a separate section should be included in Chapter VI related to the recognition of transactions for intangibles similar to the treatment in Chapter IX. Due to the increasing amount of controversy related to transfer pricing of intangibles, this part should provide guidance on items such as determining both the business purpose and the economic substance of a transaction and the consequences of non-recognition. The additional section should also address cases in which there is no comparable arm's length transaction or arrangement that can be used to benchmark a transaction or arrangement undertaken within a group of related companies.

The members of the Altus Alliance are pleased to provide these comments to contribute to the further development of chapters VI and VIII on intangible assets in the TPG.

Yours sincerely,

Ross B. Newman, PhD,

For Altus Economics and the members of the Altus Alliance