

14 September 2010

Mr. Jeffrey Owens  
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**Re: Comments on the Transfer Pricing Aspects of Intangibles**

Dear Mr. Owens:

I am very pleased to provide comments on the Transfer Pricing Aspects of Intangibles. I welcome the efforts made by the WP6 of the OECD to improve and to update the Transfer Pricing Guidelines (TPG).

I have been working on the international tax issues containing transfer pricing problems for 22 years since I joined the Office of International Operations in the National Tax Agency of the Government of Japan. As an international tax specialist, I participated the last year's Conference concerning "Transfer Pricing and the Model Tax Treaty" held in Paris and the Dialog between the OECD and the USCIB (United States Council for International Business) held in Washington, D. C. last June. Here are some comments regarding the proposal by the OECD secretariat concerning the revision of Chapter VI and VIII of the TPG.

The main points are the following;

- Scope of the Revision
- Time Frame
- Contents for Discussion

1. Scope of the Revision

Although the plan of updating both Chapter VI and VIII are announced, I strongly recommend that the upcoming revision should be limited to Chapter VI, leaving Chapter VIII unrevised this time for the following two reasons.

(1) One, emerging issues involving intangibles' transaction (e.g. transfer of the

intangibles, licensing, marketing intangibles, etc.) have become evident all over the world and thus the top priority should be given to the revision of Chapter VI.

(2) The second reason is that the lack of experience in most member countries regarding the Cost Contribution Arrangement (CCA). Not only that so far the U.S. is the only country with court rulings, but also pan-pacific nations whose TP taxations are the world's most advanced next to the US such as Japan, Canada, Australia, have not had any court decision yet. This suggests that CCA issues are not so much surfaced in countries other than the US. Under this circumstance, it is preferable not to update TPG (i.e. Chapter VIII). It will not be too late to revise the Chapter after each country gained enough experience.

## 2. Time Frame

I recommend that revision of Chapter VI be completed within next two years. TPG, first released with their mainframe in July, 1995 and later completed with Chapter VI, VII, and VIII, were kept unrevised for 15 years until 2010 after 15 years from the release. I must say that this very fact goes against TPG's mission. In other words, not updating TPG for 15 years since the introduction is equal to leaving something impractical abandoned in this rapidly changing society. Therefore, TPG should be updated every two years as the Model Tax Conventions (and/or their Commentaries).

## 3. Contents of Discussion

### Premise

Current Chapter VI has only 39 paragraphs in total and clearly needs more statements. On that premise, the following contents should be discussed.

(1) In the world of transfer pricing taxation, clarifying to certain extent the scope of intangibles considered controversial is sufficient and the definition of intangibles is no longer necessary. For such intangibles come in a variety of forms and it is hard to say 'that is all there is'. In this sense, the work must be done to add names of such intangibles, increase the overall volume of descriptions regarding those assets. It is particularly essential to indicate the meanings in terms of transfer pricing taxation and the actual cases regarding customer lists and sales network.

(2) We all know for fact that borders of intangibles and services are ill-defined in the world of transfer pricing taxation. Therefore, in Chapter VI, it should be made explicit that services are not intangibles in principle and shall be discussed in Chapter VII, while illustrating specific cases where certain services are included in intangibles as exception.

(3) In Chapter VI, it is necessary to illustrate cases when know-how, which not legally protected, falls under the category of intangibles for transfer pricing taxation purposes. For example, it is said that know-how derived from experience by employees and other human resources through business activities such as management, front-office operations, productions, R&D, and sales promotion would be treated as intangibles for transfer pricing taxation purpose even though the know-how was protected by any law. Therefore, it is very difficult to categorize know-how whether it should be included in intangibles or not. In this sense, TPG should accomplish what kind of know-how should be included in intangibles for transfer pricing taxation purpose.

(4) To deal with the issues concerning intangibles transactions, it is critical for the WP6 to focus on the ethical pharmaceutical industry. It is known that many ethical pharmaceutical companies were targeted by revenue authorities around the world from 1960s. This means that this particular industry is a typical industry dealing with intangibles. Ethical drugs involve patent which was usually developed by the R&D group in headquarters (parent company) and thus headquarters (or any other associate company) hold such patent. On the other hand, if another related party gains manufacturing approval from its country's authorities and manufactures the drug, this related party may succeed in selling the drug due to its marketing in the country. In this case, the related party had marketing intangibles by making customer lists and expanding its sales network within the country. For transfer pricing taxation purpose, I think it is essential that some guidelines be shown in TPG regarding the allocation methods of profits earned by the related companies between the patent holder and the seller.

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