

Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

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Comments on OECD “The Transfer Pricing Aspects of Intangibles”

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. in response to the solicitation of comments by OECD regarding “The Transfer Pricing Aspects of Intangibles.” The Japan Foreign Trade Council is a trade-industry association with trading companies and trading organizations as its core members, while one of the main functions of its Accounting & Tax Committee is to respond to developments in tax related matters. (Member companies of the Accounting & Tax Committee of JFTC are listed at the end of this document.)

1. General Comments

- To improve predictability for taxpayers, we request the inclusion of more descriptive examples pertaining to the definition of intangibles and to the determination of facts regarding whether transactions of intangibles exist.
- Regarding cases where double taxation has not be eliminated notwithstanding mutual agreement procedure, we would like to see OECD establish international rules for the elimination of double taxation by actively gathering information on pertinent cases from national authorities.

2. Definition of Intangibles

(1) General Definition

- The current OECD Transfer Pricing Guidelines do not go beyond giving some specific examples of intangibles and do not contain a comprehensive definition that reflects the economic and other characteristics of intangibles. Unless more concrete concepts are laid down, it will be difficult to clearly identify intangibles that are not protected by law.

For example, the definition of intangibles in IAS 38 paragraph 8 to 17 refers to (1) identifiability, (2) control, and (3) future economic benefits. We request that the definition of intangibles be clarified and internationally harmonized through inclusion of these factors in the OECD Guidelines.

- Regarding the formation of intangibles, intangibles are frequently formed through synergy among multiple tangible and/or intangible assets. Moreover, intangibles may overlap with other intangibles. Therefore, we request that complex intangibles be also covered.

(2) Intangibles Pertaining to Human Resources and Organization

- The current OECD Guidelines do not draw a clear distinction between intangibles and personal services. Partly because of this, the Japanese National Tax Agency's administrative guidelines entitled Commissioner's Directive on the Operation of Transfer Pricing include the following in intangibles: know-how and experience of employees and other forms of intangibles pertaining to human resources, and processes, networks, and other forms of intangibles pertaining to organization. The inclusion of these factors provides considerable room for discretion in tax administration. We request that OECD include explicit provisions to exclude from intangibles the management, operational, and other types of know-how obtained by managers, employees, and employee teams from their experiences in corporate activities. Know-how, trade secrets, and other factors that are obtained as a result of experience essentially pertain to the individual and do not necessarily constitute assets of the company. It is not justified to identify these matters as important factors in taxation that determine allocation of benefits between associated enterprises.

(3) Distinction between Transactions in Services and Intangibles

- Such factors as know-how and trade secrets are difficult to recognize and are not subject to legal ownership by the company. If such factors are to be included in intangibles, we request that an explicit distinction be made with services provided under employment agreement.
- Regarding business-related high-level management skills, conflicts may arise with tax authorities concerning the application of the profit split method to the provision of high value services* on the grounds that this is equivalent to the provision of intangible assets. We request that a clear distinction be made between service transactions, including high value services, and transactions of intangibles.

*Note: United States IRS Proposed Regulation section 1.482-9 dated September 5, 2003 states that the application of the profit split method would be appropriate in controlled service transactions involving “high value services or transactions that are highly integrated and cannot be reliably evaluated on a separate basis.” (However, this statement was deleted from the Final Regulation dated July 31, 2006.)

- Chapter VII is not explicitly included in the proposed revision. However, the provisions of Chapter VII are based on the assumption that services are included in intangibles. Therefore, to ensure consistency, Chapter VII should be included in the revision.

(4) Exclusion of Rights to the exploitation and production of Natural Resources

- The current OECD Guidelines do not explicitly state that rights to natural resources do not constitute intangibles. The rights to extract natural resources cannot in themselves be a source of excess profits. However, if the tax authorities recognize such rights as intangibles, claims of economic ownership may be made against extraction rights on the grounds that they contribute to the formation of intangible assets. We request that provisions be included in the OECD Guidelines explicitly stating that rights to natural resources do not constitute intangible assets in transfer pricing taxation.

3. Ownership of Intangibles

- There are no explicit provisions determining ownership of an intangible asset (owner to whom excess profits accrue) when an overseas affiliate has formed, maintained, and developed the intangible asset. We request that this matter be clarified.

4. Calculation of Transfer Prices in Transactions of Intangibles

- If a “best method approach” is to be used for calculating transfer prices in transactions of intangibles, we request that details be given of the cases to which specific calculation methods can be applied. In particular, when the residual profit split method is to be used, one of the conditions is “any unique and valuable assets” (OECD Guidelines paragraph 3.19). We request that the meaning of this be clarified. We also request clarification of the definition and calculation method of “routine profit,” and standards (standards for assessment of contribution) and methodology for allocation when residual profit is split.
- Transactions of intangibles can be mainly categorized into “transfer” and “licensing.” Therefore, we request stipulation of transfer price calculation methods based on the establishment of clear categories.
- In order to improve the Guidelines, we request the inclusion of more descriptive examples in the current Annex to Chapter VI.
- Profits generated by location saving are unrelated to contributions to intangibles. Therefore, it is necessary to establish a clear distinction between these factors.

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