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Mr. Jeffrey Owens
Director, Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development
2 Rue André Pascal
75775 Paris, France

Via e-mail: jeffrey.owens@oecd.org

Re: Project on the Transfer Pricing Aspects of Intangibles

Dear Mr. Owens:

The Toronto-Dominion Bank ("TD" or "We" hereinafter) is pleased to share our comments as the OECD considers the scope of the potential new project on the Transfer Pricing Aspects of Intangibles. In this submission, we discuss some practical and theoretical issues of significance for banks for your consideration. We applaud the OECD in contemplating to undertake this important work and would welcome the opportunity to assist and contribute to this endeavour, especially with regard to considerations from banks and financial institutions.

We wanted to share our perspective on this subject as we believe there are three important considerations which will shape how intangibles are addressed in this industry:

i) Relevant trends in the industry which may impact the business model and the implications for intangibles
ii) Banking industry value chain to identify type of intangibles and how their relative value may differ from manufacturing and other service industries
iii) Regulatory environment and requirements

Intangible assets ("IA") continue to increase in importance as key value drivers and contributors to economic profit. This certainly applies to banking as the industry transforms itself after the recent credit crisis. A number of trends will impact the value of intangibles such as the drive for cost savings and efficiencies, increased emphasis on customer relationship management, impact of new regulatory changes and capital requirements, and technological innovations impacting the way banks operate.

Understanding the bank's value chain will highlight high value added processes which may generate IA and their importance to the business.

Banks and financial institutions operate within a complex regulatory environment where regulators in every country ensure that the local operations meet certain licensing and capital adequacy requirements. Due to these regulations, banks may not be able to leverage all of their IA across borders. Therefore, for banks, once IAs have been identified, it is important to understand the regulatory restrictions when considering whether these IAs can be leveraged across borders.

Identification

As Chapter VI in the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("TPG") indicates, intangible property transactions are difficult to evaluate for tax purposes. Hence, even though the existing guidelines provide specific or hard definitions of certain intangibles, it is advisable that the better approach is to establish some basic principles and parameters for the purpose of identifying intangibles. A negative confirmation can also be an option.[1] Moreover, it is important that these new guidelines take different industry perspectives into consideration.

In the banking industry there are many examples of assets which taxpayers may consider important for their operations, such as brand name and reputation, distribution channels, customer relationships, branch network, information technology, risk management processes, culture, customer service know-how, and products, etc. It would be useful to be provided with some guidance of whether examples such as the ones listed above may be considered intangibles, in what circumstances and whether they can be contemplated as routine or non-routine.

The risk of double taxation is significantly increased when tax administrations are unable to agree on the basic question of whether or not we are dealing with an intangible. A good example to illustrate this risk is that the Obama administration in the United States is considering "clarifying" the definition of intangible to include workforce in place, goodwill and going concern. If the "clarification" effort proceeds, it will increase the complexity of evaluating intangibles, as these classifications are not universally accepted across various jurisdictions.[2]

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[1] For example, the existing TPG indicates that assets may have considerable value even though they may have no book value in the balance sheet (see Chapter VI, paragraph 6.2), expanding that into the reverse statement, where applicable, will also be helpful. That is, assets that may have book value, e.g., goodwill, may not be significant to a company's operations and need not be considered as a valuable IA in the transfer pricing analysis.

[2] Workforce in place, in practice, is generally considered under existing guidelines relating to services to evaluate the physical work, knowledge and skills contributed by the personnel. Goodwill is generally a residual accounting

These ‘clarifications’ in and of themselves are likely to increase the risk of double taxation. For example if management identified certain activities of the bank as replicable and outsourced to an affiliate in a different jurisdiction, the local tax authorities may also adopt the view expressed by the US that a workforce in place has value and therefore assert that it is the local outsourced workforce in place that creates value, and not the US management workforce in place that made the decision.

Also, there are many multinational enterprises (“MNEs”) that operate in regulated environments and the various stakeholders may also take different views on defining intangibles, which may result in irreconcilable jurisdictional differences. The guidance provided by the OECD could help redress the difficulties faced by MNEs and provide some clarity in applying the principles to the relevant situations.

Another aspect or issue relating to identification or definition is that the existing Chapter VI (see sections B and D) enlists numerous marketing-related examples. While the examples are helpful, we suggest that the project consider additional examples to better balance the potential misconception that the TPG places significant emphasis on marketing intangibles and not other commercial trade intangibles. This would be an excellent opportunity to include examples of IAs that are of relevance in today’s borderless and seamless markets. The use of banking case studies to provide guidance on when an intangible might be created or exists would also be helpful in that regard.

Another area for consideration is the ability of one entity to provide access to local markets through the requisite operating registrations and licenses granted by local governing bodies. In certain industries, these regulatory approvals are becoming increasingly costly and difficult to obtain and maintain. For example, in certain Asian jurisdictions, banks undergo a significant amount of effort to secure a license to operate, whether as a branch or otherwise, in the jurisdiction. Does that mean that such a license could be considered an intangible? We suggest that this project considers whether the access to local markets through these registrations and licenses should be treated as an intangible asset, a facilitation service, or another form of transaction.

Valuation

While the identification or recognition of an intangible is a challenge, it is even more challenging to assess and determine the economic effect of such an asset. The existing TPG named the traditional transaction and profit split methods as potentially applicable methods in evaluating transfers of intangibles. We suggest that the new project take this opportunity to examine the

value that does not necessarily provide continuing economic contribution. Going concern is another subjective matter that the market will be hard pressed to place a value on.

need for harmonization of traditional transfer pricing methods and other conventional market valuation methodologies. We enumerate some issues for consideration. The existing TPG provides that pricing should be evaluated by taking into account the arrangements that would have been made in comparable circumstances by independent enterprises. In general, conventional market valuations are normally performed on a post-tax basis, with the effect of the tax benefit or liability factored into the valuation. In contrast, traditional transfer pricing analyses are evaluated on a pre-tax basis. Hence, these differences may lead to different valuation outcomes that may impact financial statements, which may in turn lead to additional unanticipated consequences. For instance, if one of the affiliated entities were to be sold, spun off, or combined with another entity, the enterprise value of the affiliate would be influenced by all prior asset transaction valuations, including those performed for transfer pricing purposes.

We suggest that consideration should also be given to well-established definitions and valuation methodologies derived from other authoritative bodies such as the International Accounting Standards Board through the application of their International Accounting Standards, especially since there is a move to the use of such standards by the majority of jurisdictions in the future.

As mentioned previously, there are a number of assets which may be considered intangibles and it would be useful to get some guidance, whether in the form of examples or case studies that address such and the potential approaches for the valuation thereof. For example, on the issue of brands – is a charge warranted or not; is the value solely relate to the marketing efforts or is it a combination of the value derived from other assets such as the distribution functions, and networks, etc. Other questions to consider in terms of valuation in the financial services context may include the extent to which specific IAs (such as the examples mentioned above) should be valued separately or are they part of the going concern value of the bank. Another challenge which may be encountered by MNEs which operate across a number of business units is how to apportion corporate wide intangibles to specific business units that may also spread across multiple landscapes.

There have been significant developments in the global markets, economic environments and transfer pricing practices since the TPG were first drafted. Hence, related to the consideration on valuation, we suggest the project also provide guidance on factors that may impact valuation, and in particular, the use of discount rates, economic useful life and costs. Discount rates are often employed in economic and market valuation analyses, and the OECD guidance can establish helpful parameters, especially in considering the relationship between discount rates and the asset risk profile. Discussions on useful life in the existing TPG are limited, based on the distinction between trademarks and patents, where trademarks are indicated to be able to continue indefinitely, while patents are defined as being concerned with the production of goods for a limited period of time (see Chapter VI, paragraph 6.8). In a world of rapid and dynamic change and innovation, we suggest broadening the applicability of limited useful life to intangibles other than patents.

A continuing topic of debate, especially in the arena of cost contribution arrangements, is the basis of cost measurement. One specific item of contention is employee stock-based compensation. It is generally believed that independent enterprises would not contemplate sharing stock-based compensation expenses. Yet, as repeatedly noted throughout the TPG, associated enterprises may engage in transactions that independent enterprises would not contemplate. With cost contribution arrangements implying a share of all costs, this ambiguity will be ongoing. It would be very helpful for the project to reconcile the concept of arm's length principles with the definition of all costs.

Ownership

While the existing TPG recognizes that there are differences in legal and economic ownership, it is far from clear as to what that really means and how these differences may impact the relevant taxpayers. For example, the banking industry has seen a significant number of technology driven enhancements over the last number of years with more to come. Within a multinational group there may be less formality around who owns the technology, as such decisions are generally made on a group-wide basis. However, this becomes more important as group businesses may span different jurisdictions. The matter is more complicated as there may be jurisdictions that may not recognize the concept of economic ownership, such would add to tension and controversy in the case of a dispute.

We suggest that the guidelines need to focus on clarifying the differences between legal and economic ownership; the factors, considerations and examples that may impact the development of economic ownership; the implications of legal and economic ownership, some guidance on facilitating any claims by either the taxpayers or governing bodies and reasons why it is important to recognize the differences and respect the concept of economic ownership.

Conclusion

Again, we appreciate and support the work of the OECD in improving the TPG on intangibles and we welcome the opportunity to participate in further discussion with the OECD.

Yours sincerely,

"Peter van Dijk"

Peter van Dijk
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