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Mr. Owens,

Noting the request from the OECD for commentary on the current Working Party No. 6 (WP6) task of scoping a project on transfer pricing aspects of intangible assets, we respectfully submit the following for your consideration.

The views in this letter reflect those of the undersigned only, and do not constitute the opinion of Grant Thornton LLP (a Canadian member firm of Grant Thornton International Ltd.), Grant Thornton International Ltd., or any other member firm of Grant Thornton International Ltd.

Our comments are organized according to our understanding of the principal concerns of WP6.

1. Most significant issues encountered in practice in relation to the transfer pricing aspects of intangibles

Our experience gained working with multinational corporations and tax administrations suggests that there are three main practical issues encountered when dealing with transfer pricing matters relating to intangibles: the definition or identification of an intangible asset, the allocation of ownership rights, and the attribution of value to a transaction involving an intangible asset.

Definition

We find that in practice, it's often difficult or time-consuming to arrive at a mutually acceptable and workable definition of an intangible asset with a tax authority. This arises in part due to the dynamic global economy in which our clients operate, and in part due to other types of transactions that can be easily misconstrued or re-characterized as intangible asset transactions.

Ownership

The ownership of intangible assets may be characterized as either legal (*i.e.* predicated on the legal registration of the intangible asset) or economic ownership (*i.e.* predicated on the share of costs borne or risks assumed). Recent revisions to U.S. law emphasize the legal ownership of intangible assets, creating an ownership test often at odds with standard of economic ownership applied by other tax administrations. When legal ownership is applied, there are variations in the treatment of intangibles across jurisdictions even when the economic ownership, or economic reality, remains the same. This phenomenon is partly explained by the variation in property rights laws and their application from one jurisdiction to another. At the same time, it results in an inconsistent treatment of intangibles which unnecessarily induces controversies.

We find in practice that ascribing economic ownership rights amongst members of a multinational group is an exercise that must be conducted from first principles. Businesses and business models are often so different that doing otherwise creates heightened likelihood of error. We also encounter tax administrations making relatively unprincipled arguments in support of economic ownership of an intangible asset. The result is often that multinational taxpayers and tax administrations talk at odds, and find it difficult to locate common ground during controversies and progress to discussions of valuation.

Valuation

Many multinational groups expect valuation of intangible assets to be the focus of any controversy with a tax administration. This expectation is often not borne out in practice, owing in part to tax administrations being interested in matters of ownership and the appropriateness of any charge whatsoever. Rather than directing documentation effort at supporting the question of whether or not there should be a charge for the use of an intangible asset, significant effort is often expended explaining and documenting the multinational's chosen transaction value. The net effect of this disconnect is often higher cost of managing controversy, longer controversies, double taxation and general future uncertainty.

Taxpayers find tax administrations to be sceptical of the way intangible asset transactions are structured in the first instance. We hear our clients expressing concern when (a) tax administrations wish to either verify the facts of a transaction or a business in detail when significant effort and expense has been invested to comply with the documentation requirements in the tax law and to produce documentation that explains the transactions, the intangible assets themselves, and the business in which these are used, or (b) tax administration officials make unsupported "appeal to reason" arguments to justify the disregarding of a charge or a transaction as it was structured in the first instance. Often these arguments are made without a good foundation of knowledge of the business or the economic circumstances of the taxpayer. Such an unsupported "appeal to reason" argument might be expressed as: "No two third parties would agree to this deal" or "No third party would behave this way".

2. Shortfalls identified in the existing OECD guidance

Definition

In characterizing an intangible asset, the OECD Guidelines concentrate on intangible property that is associated with some commercial activity; that is, the focus is on business rights. These commercial intangibles are then broadly classified as either trade or marketing intangibles. Examples of trade intangibles include patents, know-how, designs, models and trade secrets; and marketing intangibles include trademarks, trade names, customer lists, distribution channels and unique names, symbols, or pictures which yield economic value. While the simplicity of such a classification scheme is appealing, it amplifies uncertainty around the identification of intangibles, and introduces rigidity that elevates the likelihood of transfer pricing controversies in practice. This is so because the characterization of intangibles is not only arbitrary in some jurisdictions, but also differs significantly from one jurisdiction to another in some cases. Our experience suggests this is as much a problem for tax administrations as it is for multinational businesses. The elusiveness of definitional consistency within and across jurisdictions is likely to remain a major challenge in the current dynamic global competitive economy, but this challenge can be made manageable if all parties use a rigorous definition as a starting point.

Ownership

The OECD Guidelines do not provide sufficient guidance to multinationals and tax administrations attempting to determine ownership of an intangible asset.

Valuation

Unlike tangible property, intangible assets are inherently heterogeneous and fraught with formidable measurement or valuation challenges. The application of simple depreciation rules is often inappropriate for intangibles. Some intangibles depreciate rapidly, while others do so slowly; and some may even appreciate over time. In addition, multinational corporations typically own a portfolio of valuable intangibles rather a single intangible.

In such a scenario, the valuation exercise should account for the aggregate value derived from the interaction or the complementarity of these intangibles (*i.e.* "interaction effects"), or in the alternative concentrate where practical on the value of only the intangible relevant to the transaction. The general uncertainty that surrounds the valuation of intangibles is often reflected in the usually wide range of values for intangibles. There is no systematic way of ascertaining whether a range is too wide when dealing with uncertainty in relation to the choice of depreciation rules, "interaction effects", or the forecasts of future net cash flows.

3. Areas for further OECD work

Definition

We believe an essential aspect of the WP6 work ought to be the development of a rigorous and serviceable definition of an intangible asset based on sound economic principles, and an equally rigorous statement of how by virtue of its characteristics a transaction involving an intangible asset is different from a transaction involving the rendering of services or the formalized sharing of costs using a cost sharing arrangement.

Ownership

We believe there is a need for a description of the principles employed in a test of intangible ownership in the OECD Guidelines.

Valuation

One of the important observations to be made about intangibles is that they are complex. Next, they are generated and traded by multinational corporations in a dynamic, technology-driven global economy. In such an economy, these corporations' survival depends on their ability to establish and sustain competitive advantages often due to their ownership of valuable, unique intangibles. Once tax administrations and tax payers embrace this common understanding of the economic realities, a number of guiding principles will emerge to address the kind of issues raised in this commentary. The leading principle is flexibility. That is, tax administrations must exercise a great deal of flexibility in allowing multinational corporations to accurately represent the economic realities that surround the use of intangibles, and uncertainty under which they operate. This is particularly relevant when defining and measuring intangibles.

Flexibility in respect of matters of fact cannot be used in practice without some good guiding principles concerning definition and ownership. We would greatly appreciate guidance that constitutes such a framework of principles, and encourages the objective consideration of the facts and circumstances of model multinational corporations.

We would welcome the re-examination of the concept of bundles of intangibles from a valuation standpoint, and the conditions that must be met to require unbundling of a system of intangibles for purposes of valuation.

It may be useful for WP6 to spend some of its effort updating on the current body of knowledge within the economics profession in respect of intangible asset generation, sharing and valuation. This will be important as part of the Working Party's effort to define the reasonable effort that multinationals and tax administrations should be required to expend when analysing the value of intangible assets, and how effort can be traded off against accuracy, reliability and cost.

In relation to the ownership of intangibles, the OECD guidelines neither advocate legal ownership, nor economic ownership. However, the use of the latter is likely to yield a more consistent interpretation of the economic realities that surround related-party cross-border transactions in intangibles.

And finally, a coherent approach to the treatment of intangibles calls for a greater cooperation among jurisdictions; however, we appreciate cooperation can be a demanding requirement when the erosion of a jurisdiction's tax base is at stake.

4. Suggestions on format of the final output of the OECD work

In keeping with the general nature of guidance offered to tax administrations and multinational corporations by the OECD guidelines, it would be our recommendation that the final output of the WP6 work be a revised version of Chapter VI of the OECD Guidelines. We encourage WP6 to retain a non-prescriptive presentation that provides multinationals and tax administrations with a more rigorous discussion of the fundamental definitional, ownership, and valuation aspects of transfer pricing issues relevant to intangible asset transactions.

We are supportive of the use of examples in a revised version of Chapter VI to further illustrate fundamental concepts, but would encourage that explanation of important concepts by example be avoided so as to discourage misapplication or overreliance by the users of the document.

Prior to the release of Chapter VI for public comment, we would appreciate the release of a consultation draft and an invitation to industry associations, multinational businesses, tax administrations and advisors to submit comments. The OECD's usual means of collecting commentary should work well in this instance, though we expect interest will be great due to the subject matter.

We thank you for the opportunity to provide our firm's input, and appreciate the ongoing work of the Committee on Fiscal Affairs and of WP6.

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