September 27, 2013

Sent via email to: TransferPricing@oecd.org

Organization for Economic Co-operation and Development
2, rue André Pascal
75775 Paris Cedex 16
France

Dear Sirs:

Re: Comments on Revised Discussion Draft on Transfer Pricing Aspects of Intangibles

THE CANADIAN INSTITUTE *of* CHARTERED BUSINESS VALUATORS™

The Canadian Institute of Chartered Business Valuators (CICBV) is pleased to provide our comments on your Revised Discussion Draft on Transfer Pricing Aspects of Intangibles relating to proposed amendments to Chapters I – III and the rewrite of Chapter VI of the Transfer Pricing Guidelines ("Guidelines").

BACKGROUND ON THE CICBV

The CICBV is a sponsoring member of the International Valuation Standards Council - an independent international valuation standard setting organization - and is the largest professional business valuation organization in Canada, with over 1,500 Members. It is a self-regulated organization that, in addition to governing its Members with a strict Code of Ethics and Practice Standards, grants the Chartered Business Valuator (CBV) / expert en évaluation d'enterprises (EEE) designation. The CBV/EEE designation is recognized as the premier credential for professional business valuators in Canada. The vast majority of our Members hold professional designations in addition to the CBV/EEE, such as Chartered Accountant and Chartered Financial Analyst. In addition to providing a broad range of business valuation services to Canada's business, legal, investment, banking and government communities, our Members are also active in other areas, such as financial advisory services, transfer pricing advisory services, the quantification of economic damages, and business management.

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Our Members are regularly involved in valuing intangible property in the context of the transfer of such types of property both within, and outside of, Canada. The high quality of our member's work and the importance of the CICBV professional standards are recognized by the Government of Canada's taxation authority – the Canada Revenue Agency (CRA) and by Canadian securities regulators.

CICBV's VIEW / COMMENTS

The CICBV commends the work that the OECD has undertaken to date in relation to developing guidance on the transfer pricing of intangibles, and offers its assistance to the OECD in support of its further efforts. We believe that it is important for the transfer pricing, tax and valuation professions to collaborate on this project. The CICBV appreciated the opportunity to address the WP6 in March, October 2011, and November 2012, and would welcome the opportunity to address the WP6 again to present or clarify our views and comments on the Guidance.

Accordingly, the following represents a summary of our views and comments:

1. The valuation of an intangible is a complex exercise. The robust standards and body of knowledge of the valuation profession should serve as an explicit benchmark or point of reference in the OECD's guidance, including such matters as the premise of value, definition of value, valuation methodologies, and principles. The current version of the Guidance is fairly wordy and detailed, and may benefit from the removal of detailed Guidance on valuation matters other than a reference thereto, as applicable. That is, we recommend that any Valuation guidance should exist independent from, or adjunct to, the Guidance, other than by reference to the need or application for a valuation exercise. A similar approach can be found in accounting standards; whereby, the need for a valuation exercise contained in a standard refers to fair value standards found elsewhere (i.e. IFRS 13).

2. We believe that the valuation profession, via taskforce or working party, should be commissioned by WP6 with a mandate for drafting appropriate valuation guidance on behalf of the OECD, that is consistent with the objectives, criteria, and constraints set-out by WP6, and the prioritization of the arm's length principle. Our experience and pre-existing body of knowledge could alleviate unnecessary incongruence between the valuation, tax, and transfer pricing professions.

3. The OECD should consider adopting or borrowing from valuation concepts, principles and methodologies as defined or addressed by valuation bodies such the CICBV, ASA, RICS or the IVSC. As an example, we believe that the following "fair market value" definition as a standard of value for valuation exercises necessitated by the Guidance would be

appropriate as it is consistent with, and complementary to, the arm's length principle and a taxation context.

> "the price, expressed in terms of cash equivalents, at which property would change hands between a hypothetical willing and able buyer and a hypothetical willing and able seller, acting at arms-length in an open and unrestricted market, when neither is under compulsion to buy or sell and when both have reasonable knowledge of the relevant facts"

4. In lieu of directly adopting the standards of a recognized valuation body or commissioning the valuation profession to ratify valuation standards on the OECD's behalf, we would suggest that the Guidance explicitly direct taxpayers to, and/or defer to, a valuation prepared in accordance with valuation standard-setting organizations (e.g., in accordance with the CICBV, ASA, RICS, or IVSC) on such matters as standards, terms of reference, methodologies and principles.

5. We believe that the application of valuator judgement is paramount to the validity of a reasoned valuation conclusion. Accordingly, the Guidance should avoid any reference to priority of valuation approaches, be it cost, market, or income approach. Instead, the Guidance should support the use of multiple valuation approaches, as appropriate, reasonably supported, and adequately reported. . In this regard, we highlight the following paragraphs in the Guidance which we believe are examples of where the valuator's exercise of professional judgement would be so impeded.

Paragraph 160

> "The use of transfer pricing methods that seek to estimate the value of intangibles based on the cost of intangible development is generally discouraged. There rarely is any correlation between the cost of developing intangibles and their value or transfer price once developed. Hence, transfer pricing methods based on the cost of intangible development should usually be avoided."

Paragraph 161

> "However, in some limited circumstances, transfer pricing methods based on the estimated cost of reproducing or replacing the intangible may be utilised. Such approaches may sometimes have valid application with regard to the development of intangibles used for internal business operations (e.g. internal software systems), particularly where the intangibles in question are not unique and valuable intangibles. Where intangibles relating to products sold in the marketplace are at issue, however, replacement cost valuation methods raise serious comparability issues. Among other concerns, it is necessary to evaluate the effect of time delays associated with deferred development on the value of the intangibles. Often, there may be a significant first mover advantage in having a product on the market at an early date. As a result, an identical product (and the supporting intangibles) developed in future periods will not

be as valuable as the same product (and the supporting intangibles) available currently. In such a case, the estimated replacement cost will not be a valid proxy for the value of an intangible transferred currently. Similarly, where an intangible carries legal protections or exclusivity characteristics, the value of being able to exclude competitors from using the intangible will not be reflected in an analysis based on replacement cost. Cost based valuations generally are not reliable when applied to determine the arm's length price for partially developed intangibles."

Paragraph 162

"It is sometimes suggested that certain rules of thumb may apply to determine a correct transfer price or to allocate income derived from the exploitation of intangibles between a transferor and a transferee of intangibles or rights in intangibles. The application of a general rule of thumb does not provide an adequate substitute for a complete functional and comparability analysis conducted under the principles of Chapters I through III. Accordingly, a rule of thumb cannot be used to evidence that a price or apportionment is arm's length, including in particular an apportionment of income between a licensor and a licensee of intangibles.'"

Paragraph 168

"It is also sometimes suggested that a profit split analysis can be applied to transfers of partially developed intangibles. In such an analysis, the relative value of contributions to the development of intangibles before and after a transfer of the intangibles in question is sometimes examined. Such an approach may include an attempt to amortise the transferor's contribution to the partially developed intangible over the asserted useful life of that contribution, assuming no further development. Such approaches are generally based on projections of cash flows and benefits expected to arise at some future date following the transfer and the assumed successful completion of further development activities."

Paragraph 169

"Caution should be exercised in applying profit split approaches to determine estimates of the contributions of the parties to the creation of income in years following the transfer, or an arm's length allocation of future income, with respect to partially developed intangibles. The contribution or value of work undertaken prior to the transfer may bear no relationship to the cost of that work. For example, a chemical compound with potentially blockbuster pharmaceutical indications might be developed in the laboratory at relatively little cost. In addition, a variety of difficult to evaluate factors would need to be taken into account in such a profit split analysis. These would include the relative riskiness and value of research contributions before and after the transfer, the relative risk, and the value of that risk, for other development activities carried out before and after the transfer, the useful life of the partially developed intangibles, the appropriate amortisation rate for various contributions to the intangible value, assumptions regarding the time at which any potential new products might be introduced, and the value of contributions other than intangibles to the ultimate generation of profit. Income and cash flow projections in such situations can sometimes be especially speculative. These factors can combine to call the reliability of such an application of a profit split analysis into question.'"

6. We do not support guidance that prioritizes and necessitates defining the intangible to be valued, ahead of measuring the value transferred. In our view, such an approach would appear to prioritize form over substance in a particular intangible transfer/sale, and could contradict economic realities and the transfer of economic benefits that flow from an ill-defined or yet-to-be defined intangible. This approach is further confounded by potentially divergent definitions of intangibles, legal and regulatory regimes, and unique facts and circumstances that generally accord the very nature of intangibles. We fear that an approach that cedes measuring the total value transferred as a second step, may inadvertently avoid capturing an ill-defined transfer of an intangible or something of value. In our view, the total value transferred to a related party plus any value retained by the transferor, should reconcile to the total value assuming no transfer occurred. The prior classification/categorization of this transferred value is not a precondition for its measurement. As a general approach we recommend that it is important that there should be first a measurement of whether any value has been transferred, and then that value should be classified and allocated among various intangibles such as technology, brand, contracts, as well as goodwill, according to the particular requirements of various tax jurisdictions. In this regard, we highlight the following paragraphs in the Guidance which we believe supports this position and perspective:

Paragraph 40

"In these Guidelines, the word "intangible" is intended to address something which is not a physical asset or a financial asset, and which is capable of being owned or controlled for use in commercial activities. Rather than focusing on accounting or legal definitions, the thrust of transfer pricing analysis in a matter involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction."

Paragraph 41

"Intangibles that are important to consider for transfer pricing purposes are not always recognised as intangible assets for accounting purposes. For example, costs associated with developing intangibles internally through expenditures such as research and development and advertising are sometimes expensed rather than capitalised for accounting purposes and the intangibles resulting from such expenditures therefore are not always reflected on the balance sheet. Such intangibles may nevertheless carry significant economic value and may need to be considered for transfer pricing purposes. Furthermore, the enhancement to value that may arise from the complementary nature of a collection of intangibles when exploited together is not always reflected on the balance sheet. Accordingly, whether

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an item should be considered to be an intangible for transfer pricing purposes under Article 9 of the OECD Model Tax Convention can be informed by its characterisation for accounting purposes, but will not be determined by such characterisation only. Furthermore, the determination that an item should be regarded as an intangible for transfer pricing purposes does not determine or follow from its characterisation for general tax purposes, as, for example, an expense or an amortisable asset."

Paragraph 61

"It is not necessary for purposes of this Chapter to establish a precise definition of goodwill or ongoing concern value for transfer pricing purposes. It is important to recognize, however, that the terms goodwill and ongoing concern value are often used to describe an important and monetarily significant part of the compensation paid between independent parties when some or all of the assets of an operating business are transferred. When similar transactions occur between associated enterprises, such value should be taken into account in determining an arm's length price. Similarly, when the reputational value sometimes referred to by the term goodwill is transferred to or shared with an associated enterprise by means of a trademark or other licence that reputational value should be taken into account in determining an appropriate royalty. To assure that such values are taken into account in appropriate situations, goodwill and ongoing concern value are treated as intangibles within the meaning of section A.1."

Paragraph 62

"Such treatment in no way implies, however, that the residual measures of goodwill derived for some specific accounting or business valuation purposes are necessarily appropriate measures of the price that would be paid for the transferred business or license rights, together with their associated goodwill and ongoing concern value, by independent parties. In most instances, accounting and business valuation measures of goodwill and ongoing concern value are not relevant for purposes of transfer pricing analysis."

7. We support the Guidance wherever references are made to the prioritization of substance over form; of economic determination of intangible value over definitional.

8. We recommend the prioritization of an 'Enterprise' or Top-down approach to determining the value of an intangible (i.e. first, measure the value transferred; second, allocate that value to separate intangibles), versus a bottom-up approach (i.e. first, identify and define the intangibles transferred; second, value the identified intangibles).

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9. We believe that the steps for determining the value of intangibles should follow the following process:

    a) Begin with a ***Transfer Pricing*** functional/risk- based analysis of the transferee and transferor both pre- and post-transfer, to highlight and outline the key changes arising from the proposed transfer, including but not limited to:
        (i) Risks-return profile changes;
        (ii) Ownership and control changes;
        (iii) Changes to economic benefits; and,
        (iv) Changes to functional activities.

    b) On a pro-forma basis, determine applicable intercompany charges, royalties, and transfer payments between the transferee and transferor and other related parties that will exist post-transfer;

    c) Value the transferor and/or transferee pre-transfer, based on the pre-existing functional, risk, control, and economic attributes of the enterprise, in accordance with generally accepted valuation techniques;

    d) Value the transferor and/or transferee on a pro-forma basis post-transfer, based on the proposed functional, risk, control, and economic attributes post-transfer, in accordance with generally accepted valuation techniques;

    e) Deduct the value of the enterprise post-transfer (Step c) from that determined pre-transfer (Step b), to arrive at a measurement of total value transferred;

    f) Identify and classify the intangible assets (including goodwill-type assets), that drive the total value transferred as determined in Step e, based on consideration of:

        (i) Required classifications, jurisprudence, or legalities of a particular tax jurisdiction;
        (ii) Relative risks-return profile;
        (iii) Relative ownerships and control;
        (iv) Relative economic benefits; and,
        (v) Relative functional activities that support the intangible.

    g) Allocate the value determined in Step e, to the identified intangibles (and goodwill) determined in Step f, based on generally accepted valuation techniques.

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We hope that our comments are helpful to you. It is our belief that input from members of the valuation profession will be an essential element of your considerations in this area. In this regard, we would be pleased to work with you further on this project.

If you have any questions regarding our comments, please do not hesitate to contact Robert H. Boulton, CPA, CA, CBV, our Director, Education and Standards (email: boultonb@cicbv.ca).

Yours truly,

Richard Ginsberg, CPA, CA, CBV
Chair, Professional Practice and Standards Committee