

MEMORANDUM

To: OECD, Centre for Tax Policy and
Administration, Transfer Pricing Unit

From: Anne Quenedey

Date: 30 September 2013

Subject: Comments on the Revised Discussion Draft dated 30 July 2013 containing a proposed revision of the special considerations for intangibles in Chapter VI of the OECD Transfer Pricing Guidelines

Dear Sir,

During the Meeting with Business Representatives on the Valuation of Intangibles for Transfer Pricing Purposes held on 21-23 March 2011, I was invited by delegates from Working Party n°6 of the OECD Committee on Fiscal Affairs to make a presentation on the legal protection of intangibles (<http://www.oecd.org/ctp/transferpricing/47421262.pdf>).

I have responded to the OECD request to send comments on the Discussion Draft on the revision of Chapter VI of the Transfer Pricing Guidelines dated 6 June 2012 (http://www.oecd.org/ctp/transfer-pricing/Intangibles_Comments.pdf).

During the Working Party n°6 Public Consultation held on 12-14 November 2012, I have made a presentation on the topic "*Intangibles: the relevance of property law definitions, accounting definitions and separate transferability*".

Today, I am pleased to respond to the OECD request to send comments on the Revised Discussion Draft on the revision of Chapter VI of the Transfer Pricing Guidelines dated 30 July 2013 (hereafter referred to as the "**Draft**").

First of all, we are thankful to the OECD for the responsible and serious approach taken. The Draft includes lot of elements which constitute a true evolution on establishing transfer pricing guidelines on intangibles. Substantial work have been done by the Working Party n°6 of the OECD Committee on Fiscal Affairs to propose detailed and clearer guidance and to take into consideration the comments received from the business community.

We welcome the numerous improvements made in the Discussion Draft dated 6 June 2012. Nevertheless, we have witnessed certain matters that are still missing or need to be clarified. Therefore, we would like to make the following additional comments:

- **Methodology**

From a general perspective, we welcome that the structure of the Draft includes a complete and clear methodology for determining arm's length conditions for the use or transfer of intangibles.

- The comments of the Draft include a significant work for the analysis and the understanding of the intangible transfer pricing methodology.
- However, such methodology might be sometimes difficult to implement as it entail a very detailed work for each intangible (depending on its particularism). Over the sections of the Draft, many considerations must be taken into account.
- Paragraph 89: the summary underlines that for each identified intangible, there is a complete 4-step analysis to make in order to confirm the entitlement of the legal owner to all returns attributable to the intangible.
- The question of maintaining the burden of the transfer pricing analysis at a reasonable stage should be addressed as a safeguard.

- **Usefulness of examples**

Examples included in the Draft are very useful as they constitute a practical approach of the business situations. However, it should be more clearly stated that these are only mere examples and not rules. There is a risk indeed that tax authorities, when trying to improve their knowledge and understanding of the business, take these examples as such and, classify the situations they meet under a kind of “categorisation” constituted by the sum of these examples. The generalisation of examples can be dangerous. Whereas they are important to illustrate practical situations, examples given in the Draft remain by construction theoretical. Therefore, there is a risk that tax authorities interpret the conclusions of these examples as general rules when auditing a situation that is not identical but similar.

- Paragraphs 30-33: example 5 is, as the other ones, theoretical. In practice, if the independent supplier does not exactly negotiate at the same time with the manufacturing subsidiaries in Country B and Country C, would the conclusion of the example be identical? Probably not.

- **Transfer pricing and tax havens**

The fight against tax havens and transfer pricing must be two separate tax topics. Transfer price between entities of a MNE must be evaluated at arm’s length whether such entities are located in countries which provide similar tax rates or not. References to gaps in tax rate in examples should generally be avoided. They do not give more weight to examples (see paragraph 30 for example).

- **Transfer pricing and other taxes**

We understand that the comments included in the Draft are not related to other taxes, in particular VAT and custom duties. However, the Draft should make clear that application of the transfer pricing guidelines should be made, to the extent possible, without creating difficult situations regarding other taxes. Transfer pricing adjustments should, to the extent possible, not be realized in a way that creates difficulties of analysis with respect to VAT, custom duties, or withholding taxes.

- Paragraphs 30-33: in example 5, what happens if the Country B manufacturing subsidiary invoices directly \$2,500 to the Country C manufacturing subsidiary? Which VAT is applicable? Is there a risk regarding custom duties? In other words, a situation as the one described in the example 5 cannot justify that in the event of a tax audit, the tax authority suggests the direct invoicing of the \$2,500 savings by the Country B manufacturing subsidiary to the Country C manufacturing subsidiary.

- **Assembled workforce**

The Draft should make clear that an employee group cannot be considered as a part of something which constitutes an intangible or a group of intangibles. A group of employees may have created an intangible, or some intangibles, and such intangibles can be transferred. But, in many jurisdictions, the employees as such cannot be transferred without their consent and, a MME has no legal rights on such transfer and is not entitled to a return attributable to the transfer.

- **Absence of categorisation**

Paragraph 49: there are no formal categorisations of intangibles. We fully agree on this.

- **Entitlement of the legal owner to retain portion of the return attributable to the intangibles**

The Draft comments extensively on the situations in which the legal owner does not bear all the important functions, risks and assets and is therefore not entitled to all returns attributable to the intangibles. We should not forget that the most straightforward and common situation is a situation in which the legal owner remains the more important actor and should remain entitled to the major part of the returns.

- In particular, paragraph 80 states that “*where the legal owner outsources most or all of such important functions to other group members, the entitlement of the legal owner to retain any material portion of the return attributable to the intangibles after compensating other group members for their functions is highly doubtful*”. It is not always the case, some entity of a group may outsource functions and risks relating to an intangible to third parties and retain nevertheless residual profits on such intangible because it keeps major decisions relating to the intangibles.

- **Transfer pricing methods**

Paragraph 34 “*MNE groups and tax administrations retain the freedom to apply methods not described in Chapter II of these Guidelines (hereafter “other methods”) to establish prices [..]. Such other methods should not be used in the substitution for OECD-recognised methods where the latter are more appropriate to the facts and circumstances of the case*”. It is very important that the Draft confirms freedom for MNEs to use other transfer pricing methods than the one described in the Draft. However, this freedom is subject to the demonstration of “more appropriate” criteria, which are not defined and which open the doors to endless discussions with tax authorities. This should be clarified.

We are at the disposal of the Working Party n°6 in order to contribute further, in particular on the combination of the various criteria or the clarifications on the limits.

Very truly yours,

Anne Quenedey,
Partner