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By E-Mail: TransferPricing@oecd.org

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

Dear Mr. Andrus,

Thank you for the opportunity to provide comments on the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles (“Revised Draft”), containing revisions to Chapters I to III and Chapter VI of the OECD Transfer Pricing Guidelines (the “Guidelines”). Please find below our comments and suggestions of issues to address.

Comments on the Revised Draft

General

1. Overall, the Revised Draft provides a more comprehensive guidance on transfer pricing aspects of intangibles when compared to the Discussion Draft on Transfer Pricing Aspects of Intangibles published on June 6, 2012 (“Original Draft”). However, there are still important issues, described in detail below, that require further consideration and/or guidance by the OECD. Many of these issues were apparent in the Original Draft and therefore our original submission, dated September 14, 2012 (“2012 submission”), is still relevant. Appendix I includes the 2012 submission.

2. The ultimate objective of the OECD with respect to transfer pricing aspects of intangibles, and more generally, transfer pricing, should be to provide guidance that is (i) fair, (ii) simple to execute, and (iii) provides certainty to taxpayers. The Revised Draft does not achieve this objective more readily than the Original Draft as the Revised Draft does not succeed in addressing the ambiguity to taxpayers with respect to transfer pricing aspects of intangibles and adds additional complexity to the analysis taxpayers are required to undertake in determining the transfer price for the use or transfer of intangibles.

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3. Furthermore, the Revised Draft presents numerous examples for which the purpose is to assist taxpayers and tax administrations in understanding and managing the complexity of the framework and concepts outlined. However, the examples are not more realistic and/or useful than those in the Original Draft. The fact patterns described in the examples are so absolute that the result is in an overly simplified analysis and conclusion that have no practical usefulness. In order for the examples to be more beneficial, they should be revised such that the fact patterns approximate the realities encountered by parties not dealing at arm's-length thus allowing for a more relevant and extensive exploration of the application of the Guidelines.

Chapter IV – Special Considerations for Intangibles

Identifying Intangibles

4. The Revised Draft retains a broad definition of intangibles, as in the original draft. The main change to the definition is the addition that an intangible is something "whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances". This implies that the key factor in determining when an asset constitutes an intangible is whether parties that deal at arm's length would agree to pay a compensation for such an asset. However, this addition to the definition does not provide more concrete guidance to taxpayers on how to identify intangibles. Therefore, the comments and recommendations made with reference to the definition of intangibles found in paragraphs one to six from the 2012 submission, found in Appendix I, are still relevant and applicable.

Ownership of Intangibles and Transactions Involving the Development, Enhancement, Maintenance and Protection of Intangibles

5. The language that is currently used in the Revised Draft does not improve on the Original Draft in that it continues to undermine the importance of legal ownership of intangible assets and the assumption of risk in a transfer pricing analysis, and emphasizes that the underlying principle in determining the entitlement to intangible-related returns is hinged on the identification of the entity that performs and/or controls the most important functions with respect to the development, enhancement, maintenance and protection of intangibles (referred to hereinafter as the "important functions").

6. Even though the identification of the legal owner of an intangible seems to be the starting point of the suggested framework to analyze transactions involving intangibles, and the Revised Draft includes the consideration of alignment between legal ownership and important functions, it becomes evident that the "*control over the most important functions*" test supersedes the entitlement of a legal owner of intangibles to intangible-related returns. The Revised Draft emphasizes this more strongly than the Original Draft by delving more deeply into the important functions and their alignment with legal ownership.

7. In our opinion, there must be some ground rules for both taxpayers and tax administrations to follow as it relates to intangible-related return. The legal ownership of intangibles and the legal substance of transactions involving intangibles should serve as a basis for these ground rules. This will enable the guidance on transfer pricing aspects of intangibles to achieve its ultimate objective of being practical and unambiguous to follow.

8. Paragraph 66 of the Revised Draft provides a more explicit framework, as compared to the Original Draft for analyzing transactions involving intangibles, with the first step being the identification of the legal owner of the intangible, based on existing legal arrangements.

9. We agree with the proposed framework for analyzing transactions involving intangibles. However, we submit that the guidance provided in paragraph 73 is contradictory to this framework. In particular, paragraph 73 states that "*the question of legal ownership is separate from the question of remuneration under the arm's length principle*", and that "*legal ownership is simply a reference point for identifying and analyzing controlled transactions relating to the intangible*". These two statements illustrate what appears to be the overall message of the OECD in the Revised Draft, namely, that the legal ownership is not the primary factor when it comes to the determination of the entity entitled to intangible-related returns. We submit, however, that the legal ownership must be the principle factor in determining intangible-related returns.

10. The Revised Draft clarifies that the purpose of scrutinizing legal arrangements is to disallow certain abusive behaviors by taxpayers. However, we do not believe that the purpose of the Guidelines is to address abusive behaviors, as there are other instruments available to tax authorities to prevent these arrangements, be it through domestic law or international tax treaties[1]. Moreover, it is part of the OECD's Base Erosion and Profit Shifting ("BEPS") action plan to develop other instruments to address tax abusive behaviors by taxpayers.

11. The purpose of the Guidelines should be to provide both taxpayers and tax administrations with a clear, and as explicit as possible, guidance on transfer pricing. However, the current guidance in the Revised Draft does not provide taxpayers with a clear roadmap on how to analyze transactions involving intangibles, but rather creates a more ambiguous landscape, where both taxpayers and tax administrations have more "room to maneuver" when it comes to important questions, such as the determination of the entity that exercises control over the most important functions. This type of approach is problematic as it may result in a double taxation, as a result of different interpretations by tax administrations.

12. We strongly believe that having the legal framework, especially when it comes to transfer pricing aspects of intangibles, as a foundation of the transfer pricing analysis would serve this purpose. Therefore, we urge the OECD to redraft the Revised Draft such that the legal ownership of intangibles and the legal substance[2] of transactions involving intangibles would not be undermined or, even worse, disregarded.

Functions, Assets, and Risks Related to Intangibles

13. Paragraph 75 provides that the key consideration in determining which entity is entitled to returns attributable to intangibles is the identification of the member of the group that performs and/or controls the important functions. Paragraph 76 provides further that it is not essential for the legal owner to perform all of the important functions through its own employees in order to be entitled to intangible-related returns. However, it indicates that the legal owner should retain ***control*** over the outsourced functions.

14. Furthermore, paragraph 80 of the Revised Draft illustrates that the performance of the important functions supersedes the importance of assets used and risks assumed, by stating that where a legal owner of an

[1] Certain countries include provisions within their domestic tax law or within international tax treaties to address a tax abusive behavior. Examples of this within domestic tax law include Canada's general anti-avoidance rule ("GAAR"), which can be used to disallow arrangements the sole purpose of which is to avoid tax, or its foreign accrual property income ("FAPI") regime, which taxes the passive income earned by a controlled foreign affiliate of a Canadian entity. Examples of this within international tax treaties include the limitation on benefits provision within the Canada-US Tax Convention, the purpose of which is to prevent treaty shopping.

[2] For greater clarity, the term "legal substance" refers to both the legal form (contractual arrangements) and the conduct of the parties that is consistent with the legal form.

intangible outsources most or all of the important functions to other members in the group, the legal owner's entitlement to retain any material portion of the return attributable to the intangibles is highly doubtful. This, again, undermines the legal owner's control over the important functions and, as such, the entitlement to intangible-related return.

15. In our view, there are two factors which constitute "control": first, whether the entity has the capacity to undertake the requisite decision making in regards to the outsourced function; and secondly, which entity bears the cost associated with the outsourced function.

16. The first factor pertaining to the capacity to undertake decision making can be manifested both in the actual functions carried out by persons (e.g. employees, agents, directors) on behalf of the entity or in the decisions made by the "mind and management" of the corporation, as embodied in the decisions made by the board of directors of a corporation.

17. The second factor that manifests control is the assumption of costs related to the function, asset or risk in question. Costs can relate both to the actual cost to perform the function, acquire the asset or assume the risk or the cost of any consequences arising as a result of performing the function, owning the asset or assuming the risk. Therefore, the assumption of costs related to the function is in itself a manifestation of control over that function. Put simply: if you pay someone to do something for you, you do not have to control (and oftentimes you cannot control) what that person does, but ultimately you benefit or lose from the outcome of his work. To illustrate, consider the following common arrangement whereby a wealthy individual ("investor") engages a professional portfolio manager to manage his investment portfolio. Accordingly, this investor entrusts the investment decision, i.e. the "most important function" in this arrangement, to the portfolio manager. In such a situation, the remuneration to the investor is generally a percentage fee based on the performance of the investment portfolio, and any gains or losses resulting from the investment decisions accrue to the investor. In other words, the investor bears the complete risk associated with the investment decisions of the portfolio manager, whereby the investor has little or no control over the investment decisions themselves. This illustrates that the control is evidenced by the assumption of the financial risk.

18. Therefore, we urge the OECD to revise the Revised Draft such that the legal owner, who has the capacity to undertake decisions and is financially responsible for the development, enhancement, maintenance and protection of intangibles, is fully entitled to intangible-related returns. The question of control over the important functions should only be relevant once it is established that the legal owner, in substance, does not have the capacity to undertake decisions and to financially control these functions. For example, if the legal owner of a trademark does not incur directly or indirectly any costs associated with the protection or enhancement of the trademark and, in case of infringement, would not be capable of providing financial support to protect the trademark, the entitlement to the trademark royalty collected from a related party may be questioned. On the other hand, if the legal owner of a trademark be it a holding company or an operating company, maintains legal liability risk, directly incurs expenses or reimburses the other entity for expenses incurred in connection with the trademark, its entitlement to the trademark royalty should not be questioned.

Supplemental Guidance Regarding Transfers of Intangibles or Rights in Intangibles

19. The Revised Draft discusses the use of valuation techniques in situations where reliable comparable uncontrolled transactions cannot be identified. Although the use of valuation techniques for transfer pricing purposes is allowed in the context of the valuation of intangibles, the Revised Draft indicates in paragraph173

that "*caution should therefore be exercised in accepting valuations performed for accounting purposes as necessarily reflecting arm's length prices or values for transfer pricing purposes without a thorough examination of the underlying assumptions. In particular, valuations of intangibles contained in purchase price allocations performed for accounting purposes are not determinative for transfer pricing purposes...*"

20. The objective of valuing intangible assets for commercial and accounting purposes is to establish a "fair value" to assist in determining a selling or purchase price of the asset(s) and to report these fair values to the stakeholders of financial information. For transfer pricing purposes, the goal is to establish an appropriate arm's length entitlement to intangible related returns. All of these purposes have the same fundamental objective, which is to determine a fair market value of the intangibles.

21. In the context of a purchase price allocation, whereas the starting point of a valuation exercise is establishing an arm's-length price paid for a business, the value (or a range of values) of an individual intangible asset determined using generally accepted valuation techniques represents an arm's length value (or a range of values) of that intangible. Even though the treatment of intangibles for transfer pricing purposes may differ, we do not understand why the value determined under the purchase price allocation cannot be used for transfer pricing purposes without extensive further examination and/or with a complete shift in the underlying assumptions.

22. Furthermore, having to perform adjustments for transfer pricing purposes to the value established for accounting or commercial purpose will lead to greater uncertainty for both taxpayers and tax administrations, as well as allow more room for manipulation. Similarly to transfer pricing, valuation is not an exact science and there are certain assumptions that have to be made to arrive at a fair market value of an intangible. We recognize that it is the responsibility of transfer pricing practitioners to ensure that the underlying assumptions are reasonable and consistent with the facts specific to a given transfer pricing analysis, but do not believe this necessitates a complete disregard of valuations performed. Therefore, transfer pricing practitioners should rely, while maintaining professional skepticism, on valuation exercises performed by valuation practitioners.

23. Our view is that there should be no such distinction between a value for transfer pricing, tax or accounting purposes. We strongly believe that once a valuation approach is determined to be the most appropriate in determining the value of an intangible for transfer pricing purposes, it should be used without lengthy inquiries into the assumptions used to arrive at a fair market value.

24. We encourage the OECD to revise the guidance regarding the valuation of intangibles such that valuations are not completely disregarded, and instead, are used responsibly by transfer pricing practitioners. This will lead to greater assurance that values are not established with a transfer pricing or tax bias and will ensure a greater likelihood of representing a fair market value.

25. Finally, the Revised Draft speaks against the application of a rule of thumb, including in particular an apportionment of income between a licensor and a licensee of intangibles (known in valuation as a the "25/75 rule"). We do not believe that the use of a rule of thumb for transfer pricing purposes should be completely disallowed. Even though a rule of thumb may not lead to the determination of a precise arm's-length value or a range of values, it may still be useful as a secondary methodology to test the outcome of the primary methodology, be it a CUP or a valuation method. In valuation practice, it is often the case that a rule of thumb is used as a sanity check for the reasonability of the primary methodology. Therefore, we believe that the rule of thumb should be similarly allowed for transfer pricing purposes.

Proposed Amendments to Chapters I-III of the Transfer Pricing Guidelines

26. The Revised Draft expands the guidance on comparability factors in Chapter I of the Guidelines by including location savings and other local market features, assembled workforce, and group synergies, and providing that these factors are not considered intangibles, but are relevant comparability factors in a transfer pricing comparability analysis. We agree with the differentiation of value drivers that are relevant in a comparability analysis from intangibles.

27. Generally, this approach, is an improvement over the Original Draft in the context of aligning the definition of intangibles with the illustrations (refer to paragraph 3 and paragraph 8 of the 2012 submission found in Appendix I). The Revised Draft, however, still fails to address (i) valuation for the purposes of a comparability analysis for items such as assembled workforce and group synergies, and (ii) the practicality of isolating the value of these items in order to perform a comparability analysis.

28. The Revised Draft, therefore, does not achieve the overall objective of providing guidance that is simple to execute and that provides certainty to taxpayers. Our recommendations from the 2012 submission, found in paragraphs eight to ten, are still relevant and we encourage the OECD to consider the relevance and practicality of using these factors in transfer pricing analyses.

29. Specifically, while we appreciate the attempt to provide guidance where none was available in the Original Draft, the guidance with respect to the assembled workforce provided in section D.7 is ambiguous. Even though the assembled workforce is not an intangible asset, paragraph 17 indicates that, in some situations, the transfer or secondment of one or more employees may result in the transfer of valuable know-how from one member of the group to another. In such situations, the Revised Draft provides that the resulting transfer of know-how should be separately analyzed under the provisions of Chapter VI, and an appropriate price should be paid for the transferred know-how. Furthermore, paragraph 17 provides that access to an assembled workforce with particular skills and experience may, in some circumstances, enhance the value of transferred intangibles or other assets, even where the employees making up the workforce are not transferred.

30. The question of a transfer of any intangible, including valuable know-how, should be governed by the legal arrangements between the associated enterprises. A transfer of an intangible does not arise by the mere fact that an employee has been transferred or seconded, as an employee is not the legal owner of that intangible. Therefore, a transfer of an intangible can only occur where there is a legal arrangement between the parties for the transfer of an intangible.

31. Furthermore, it is questionable whether this guidance is congruent with the definition of intangibles as outlined in paragraph 40. The definition of an intangible as presented in the Revised Draft states that it “is capable of being owned or controlled for use in commercial activities”. Thus, the guidance relating to the transfer of employees implies that employees can be owned or controlled, which is not a realistic situation.

32. In our opinion, paragraph 17 should be removed from the Revised Draft to avoid ambiguity that may result from different interpretations, which may serve as a basis for disputes amongst taxpayers and tax administrations. With the globalized approach in conducting business today and the ease of geographic transferability of employees, taxpayers should not be concerned with the transferability of an intangible every time there is a transfer or secondment of an employee.

33. Furthermore, the Revised Draft provides that group synergies are not an intangible asset, but should be considered when performing a comparability analysis. We do not agree with this position as we believe that group synergies should be ignored for transfer pricing purposes because, by definition, the arm's length principle dictates to price transactions as if parties are dealing at arm's length and, therefore, the effect on pricing from factors such as group synergies in a controlled transaction should be ignored.

Conclusion

Thank you again for the opportunity to share our comments with the OECD on transfer pricing matters. As always, we welcome guidance from the OECD to facilitate the application of transfer pricing principles for both tax administrations and taxpayers.

Yours very truly,

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