Organization for Economic Cooperation and Development
2, rue Andre Pascal
75775 Paris Cedex 16
France

By email: transferpricing@oecd.org

Comments provided by PwC in its capacity as a professional organization.

October 1, 2013

Dear Sirs,

Revised Discussion Draft on Transfer Pricing Aspects of Intangibles

Thank you for the opportunity to provide comments on the revised discussion draft on transfer pricing aspects of intangibles (the "Revised Discussion Draft"). As a general matter, PwC supports the work being undertaken by the OECD to address the transfer pricing challenges associated with intangibles.

Our more detailed comments on specific sections of the Discussion Draft are provided below.

Section A: Identifying Intangibles

Definition of Intangibles

1. We agree with the acknowledgement that an assembled workforce is a comparability factor which may affect the arm's length price of services provided between related parties, but it is not by itself an intangible. We also agree with the guidance that the valuation of an assembled workforce essentially may be limited to the time and expense savings in recruiting a new workforce (and may in some cases be negative, where the transfer of workforce creates liabilities). Any savings from having an assembled workforce in place should be reflected in the arm's length price of the services rendered by the workforce.

2. However, the Revised Discussion Draft as currently written leaves ambiguous whether the relocation of a single employee may be tantamount to a transfer of know-how. We are concerned that this language may unduly constrain the flexibility of businesses to deploy workers to different jurisdictions. Given increased globalization and corresponding increases in the mobility of workers, it is imperative that employers are able to reassign employees around the globe without concern for a finding of a transfer of know-how or other intangibles. A transfer of know-how should be compensated at arm's length, but we believe this will only occur in rare instances when an employee works outside of his or her home jurisdiction. Such an employee would use know-how by necessity in performing services, but this is not a

transfer of know-how. In addition, a transfer of know-how can occur in many different forms and should be compensated at arm's length; however, we do not believe that transfers of know-how by transfer or secondment of employees should be singled out specifically. We caution that such an approach raises a significant compliance burden for taxpayers.

3. We agree with the OECD's provision of guidance for goodwill in paragraph 60, that "goodwill reflects the difference between aggregate value of an operating business and the sum of the values of all separately identifiable tangible and intangible assets." However, we remain concerned that the inclusion of goodwill and going concern value within the definition of intangibles may lead to significant overvaluation of transfers of assets. Specifically, we have witnessed tax authorities' attempt to price the transfer of any group of assets as if it were a transfer of all or a part of a business, with a signification increase in valuation attributed to goodwill and going concern value. We believe if tax authorities apply this concept too broadly, it may lead to the imposition of a tax on "business opportunities."

4. We believe that goodwill and going concern value should not be included within the definition of intangibles. If included, cautionary language should be added noting that goodwill and going concern should be separately compensated in a limited set of circumstances (e.g., where there is an actual transfer of a business, which has been structured as such by the taxpayer). , in order to avoid double-counting, it should be noted that paragraph 153 already discusses the concept of aggregate valuation, which seems to encompass the same concept as goodwill and going concern value, and that those two concepts should not be applied simultaneously to any transaction or group of transactions.

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

Emphasis on Functions versus Assets and Risks

5. The Revised Discussion Draft introduces "return attributable to an intangible" or "intangible related return" to account for the allocation of income in intercompany transactions involving intangibles and specifically highlights important functions that have special significance in paragraph 79. We believe this has the potential to lead to an overemphasis on the functions performed in a related party transaction when undertaking a transfer pricing analysis and in so doing may downplay the role of the assets and risks associated with a given transaction. Furthermore, we believe this creates a third category of "special" functions as defined by the OECD, when referring to specific functions such as the key entrepreneurial risk taking function or significant people functions, as described in the Permanent Establishment paper.

6. We recommend the Revised Discussion Draft state that it only seeks to clarify the key points in a functional analysis of an intangibles transaction and that it does not attempt to place greater emphasis on where people are located and performing functions and less emphasis on legal ownership of intangibles and contractual assumptions of risk. We recommend the Revised Discussion Draft state that it does not intend to fundamentally shift the traditional functions, assets and risk analysis but only seeks to clarify the functions that are "fundamentally important" in such a functions, assets and risk analysis.

7. We recommend that the Revised Discussion Draft reiterate that it is based on the principles of Article 9 of the OECD Guidelines, which respects legal form and allows risk to be

contractually diversified across affiliates. The introduction of important functions has the potential to be interpreted as shifting transfer pricing analysis towards an Article 7 approach which would consider the location of significant people functions when allocating risk, capital and related returns. Further, the Revised Discussion Draft does not currently clarify on a qualitative level how much of each listed function is sufficient. In addition, we believe that the Revised Discussion Draft should acknowledge that certain other functions may also be critical for different types of companies and industries. It would be helpful if the OECD could firmly state this in the final text.

8. We agree with paragraph 76, in which the Revised Discussion Draft recognizes that a funder may outsource functions yet be entitled to “retain returns related to funding and risk…” We agree that it may be appropriate for an entity to hire other parties to undertake certain functions while retaining the returns to an intangible if the parties are mutually induced into the transaction and appropriately remunerated based on their functions performed, risks assumed and assets owned.

9. We recommend the concept “important functions” in paragraph 79 be grounded in arm’s length principles. These functions should demand larger remuneration only to the extent that third parties operating in similar circumstances would require such larger remuneration, based on a functions, assets and risk analysis. Which functions are deemed to be important is subject to the facts and circumstances of particular transactions and cannot be generalized across transactions.

10. We do not agree with paragraph 81 that the reliability of a one-sided transfer pricing method will be substantially reduced if the party performing the important functions is treated as the tested party. As with all transactions, we recommend the Revised Discussion Draft state that the selection of the best method is a holistic analysis that is dependent on the facts and circumstances of the transaction being reviewed. Furthermore, we ask that the Revised Discussion Draft recognize that the selection of the most appropriate method often reverts to a selection of the most reliable method given the data available and may devolve into a selection of a method by default.

11. We recognize that rules of thumb are not a substitute for thorough analysis. However, we consider rules of thumb to be a useful part of a more rigorous analysis when testing the reasonableness of a transfer pricing method. As such, PwC welcomes an increased reliance on safe harbours where reasonable to do so. We believe that safe harbours are favourable when anticipated to avoid distorting income vis-à-vis an arm’s length result, not when they may lead to exploitation of loopholes (i.e., where safe harbours may be used as an optional tool to manipulate results such that it would only be used by a company or government when advantageous to do so). This is particularly relevant given the attention to the corporate value chain as recorded in the White Paper on Documentation which, as drafted, will require a thorough analysis by the taxpayer of the contributions of important functions vis-à-vis contractual arrangements. This will require a less “mechanical” approach for complex transactions which will be more time consuming for companies so it would be welcomed if simplification would be endorsed further for less complex transactions. Finally, we also caution that safe harbours must only be applied when elected by taxpayers. “Safe harbours” which apply by default unless a taxpayer can “prove out” by demonstrating that they are not arm’s length are not truly safe harbours at all, and raise the spectre of deviating from the arm’s length standard in favour of a fixed margin approach used by countries such as Brazil.

Recharacterization

12. Paragraph 66 provides the framework for analyzing transactions involving intangibles in six steps including identification of legal ownership, functional and transfer pricing analysis, and, in exceptional circumstances, recharacterization.

13. With the apparent emphasis on important functions and what is required of the IP owner according to paragraph 80, the focus is on a traditional, transactional transfer pricing analysis, requiring benchmarking, an assessment of comparability and consideration of the "actual conduct" by parties engaged in a transaction. We are concerned that there is currently not enough detail in publicly available benchmarking data to reliably address comparability in all cases and this may encourage a more widespread use of recharacterization. It would be helpful if the OECD could emphasize that it is not the intention to allow recharacterization / disregarding in other than exceptional cases, e.g., as was concluded during the work on Chapter IX on Business Restructurings (see below section 15).

14. Recharacterization is further considered in paragraph 80 which states that in certain scenarios where independent third parties would not have undertaken a transaction in a particular manner, it may be necessary to disregard the actual structure adopted. We believe the reference in paragraph 80 stands in contradiction to paragraph 1.11 of Chapter I of the July 2010 OECD Transfer Pricing Guidelines which recognizes that, because of their common control and common interests, related parties can and do enter into transactions which unrelated parties would or could not. This paragraph further recognizes that the mere fact that a transaction may not take place between independent parties does not itself mean that the transaction is not arm's length. We recommend the Revised Discussion Draft clarify that the mere fact that independent third parties would not have undertaken a transaction in a particular manner is not sufficient grounds to recharacterize or disregard a transaction. For further reinforcement of paragraph 1.11, we suggest referring to section C.3 of Chapter 9 of the OECD Guidelines for Multinational Enterprises.

15. We recommend that the Revised Discussion Draft reiterate that transactions should only be disregarded or recharacterized in exceptional circumstances and such disregard or recharacterization should be based on economic substance considerations.

Section D: Supplemental Guidance for Determining Arm's Length Conditions in Cases Involving Intangibles

Valuation Techniques - General Comments

16. The Revised Discussion Draft explicitly approves of the use of valuation techniques, particularly those that are premised on the discounted value of projected future income streams or cash flows attributable to the intangible as stated in paragraph 171. However, paragraph 173 caveats it is important to consider the underlying assumptions, ensuring that such techniques are applied using assumptions consistent with the arm's length principle. The Revised Discussion Draft notes that subtle change in assumptions can create large changes in the outcome of valuations, and as a result, it is critical to consider accuracy of financial projections; assumptions regarding growth rates; estimates of discount rates; useful life and terminal values; and, assumptions with respect to taxes as laid out in paragraph 175. As discussed in the comment paper submitted by PwC following the initial intangibles draft

paper on June 6, 2012, such small changes have the largest impact when pursuing a useful life that lasts in perpetuity.

17. In this regard, PwC asks that the OECD further clarify the circumstances when a terminal value attributable to a useful life calculation may appropriately be eschewed. In its current form, paragraph 194 states that "...it should be recognized that, while some intangibles have an indeterminate useful life at the time of valuation, that fact does not imply that non-routine returns are attributable to such intangibles in perpetuity." This does not specify the facts and circumstances under which it may be appropriate to forego a terminal value calculation. Provision of specific scenarios where a perpetual useful life calculation may not be assumed would provide much needed guidance to both taxpayers and tax administrations.

18. Additionally, we note that while some intangibles are useful in perpetuity (either by themselves, or as the "platform" upon which future intangibles are developed), that is a different question than whether they ought to be paid for in perpetuity. Arguably, at a certain point in time, the right to payment for the initial invention should cease where the value from the initial intangible becomes so attenuated that it is dwarfed by the development and other work that is performed subsequently. The question is always where to draw that line; we believe that in practice tax authorities have tended to require compensation for the original invention much longer than such compensation would have been agreed to between unrelated parties. We suggest guidance that compensation is not required in perpetuity for intangibles transfers and that the value of subsequent contributions to the value of those intangibles is considered as part of the pricing analysis.

19. Further, we understand that it is not possible for the OECD Guidelines to address every aspect of valuation techniques utilized in a business context. We also appreciate the Revised Discussion Draft's shift in stating that purchase price allocations used for accounting purposes are not necessarily *determinative*, as opposed to not *relevant* for transfer pricing purposes cited in paragraph 173. We disagree, however, with the notion that taxing authorities should examine and compare the valuation and underlying assumptions made for valuation purposes versus the valuations made for tax and / or transfer pricing purposes as outlined in paragraphs 178. In such cases, paragraph 179 that "valuations used by an MNE group in making operational business decisions may be more reliable than those prepared exclusively for purposes of a transfer pricing analysis." We are concerned that tax authorities may interpret this paragraph and assume that valuation techniques for non-tax purposes are more reliable and therefore examine valuations for transfer pricing purposes through such a vantage point. The Revised Discussion Draft further states, "[i]t would be reasonable for a tax administration to request an explanation for any inconsistencies in the assumptions made in a valuation of an intangible undertaken for transfer pricing purposes and valuation undertaken for other purposes," then gives two examples where different discount rates may be utilized or different useful life calculations are adopted. While we agree that such differences should fairly require an explanation, we request that the language acknowledge that such inconsistencies are not necessarily determinative of conclusions regarding the reliability of the analysis undertaken for transfer pricing purposes. Given that valuations done in a business context may have arisen under different circumstances and have been subject to different assumptions, an explicit acknowledgement of legitimate reasons for inconsistencies is necessary to prevent MNEs acting in good faith from being automatically viewed as non-compliant taxpayers.

Profit Split Method of Valuation

20. The Revised Discussion Draft seems to encourage increased use of profits splits to value intangibles. As drafted, this seems inappropriately prescriptive; no transfer pricing method should be preferred before the functional analysis has been performed and we recommend such a clarification be included.

Valuation Techniques Where Valuation of Intangibles is Highly Uncertain

21. With regard to valuation techniques when valuation is highly uncertain at the time of the transaction, we note that paragraphs 199-206 are explicitly intertwined with the BEPS Action Plan, which states that a future area of focus involves the transfer pricing treatment of "hard to value" intangibles. In particular, with regard to comparability of circumstances involving highly uncertain projections, paragraph 203 states that "if independent enterprises would have fixed the price based upon a particular projection, the same approach should be used by the tax administration in evaluating the pricing."

22. We are concerned that this approach may be interpreted to advocate an evaluation of transfer prices for highly uncertain intangibles on an *ex post* basis, where such information regarding projections may not have been available at the time because of unforeseen circumstances. It is important for the Revised Discussion Draft to note that the use of such a comparability factor must be weighed in light of the actual information available at the time of the transaction between the associated enterprises. This is consistent with the mandate in the Revised Discussion Draft that valuation techniques utilized in a transfer pricing analysis involving the transfer of intangibles should be applied in a manner that is consistent with the arm's length principle. Given that third parties often enter into agreements where the valuation of intangibles is uncertain without the benefit of hindsight, the valuation of intangibles, in particular those with highly uncertain values at the time of the transaction, is appropriately undertaken on an *ex ante* basis.

23. We would like to point out our concern regarding the language used in the Revised Discussion Draft with respect to the valuation of highly uncertain intangibles. Paragraph 204 in particular states:

> It is recognized that a tax administration may find it difficult, particularly in the case of an uncooperative taxpayer, to establish what profits were reasonably foreseeable at the time that the transaction was entered into. [...] In such a case, the subsequent developments might prompt a tax administration to inquire what independent enterprises *would have done* on the basis of information reasonably available at the time of the transaction.

24. Paragraph 204 further expounds on this statement by providing that "consideration should be paid to whether the associated enterprises intended to and did make projections that independent enterprises would have considered adequate ... and whether enterprises would have insisted on some additional protections against the risk of high uncertainty in valuation."

25. Our concern with this language is two-fold. First, applying a test after the resolution of a transaction where risk plays a central role is unlikely to yield a reliable outcome that is consistent with the arm's length standard. This ex-post vantage point is in contrast to application of the best method under the Section 482 Regulations and the OECD Guidelines generally, both of which apply a prospective approach. Second, the mechanics of applying test on an ex-post basis to benchmarks the profit of a *single* transaction may have the effect of disregarding other transactions that may or may not result in a reasonable rate of return. We would suggest that the Revised Discussion Draft be clarified to reflect that although tax authorities may be prompted to require what independent enterprises *would* have done, it would be not proper to apply this information from an *ex post* vantage point.

Location Savings

26. We would first like to recognize the large strides achieved between the first Discussion Draft and the Revised Discussion Draft with regards to locations savings. Unlike the previous Discussion Draft, the Revised Discussion Draft devotes a section to the discussion of location savings. This, in the view of PwC, is a welcome revision given that location savings are a topic of much discussion and, at times, debate between responsible taxpayers and tax administrations. Further, location savings is one of the areas of greatest divergence among tax administrations seeking to apply the arm's length standard. Therefore, guidance and consistent application in this area should lead to a greatly reduced number of international disputes, greater certainty for taxpayers, and greater efficiencies in the governance and administration of taxing regimes. In sum, it is our hope that strong and clear guidance in this area will save all parties much wasted time and effort and enable taxing regimes to devote greater resources to the examination and study of overly-aggressive taxpayers and non-compliant entities.

27. As the Revised Discussion Draft correctly concludes, location savings is a comparability factor and not itself an intangible. This is the correct conclusion given that location savings cannot be owned or controlled for the use of commercial activities. Therefore, in applying the Revised Discussion Draft's own definition, location savings are not intangibles and should not be treated as such. This is a great step forward. While all agree that location savings should be addressed in applying the arm's length standard, the proper categorization of location savings is a question of first importance that, once answered, will help ensure greater uniformity in their treatment.

28. Moreover, the Revised Discussion Draft also rightly states that where comparable entities and transactions in the local market can be identified, then separate comparability adjustments should not be required. This conclusion is correct and in accord with previous guidance from the OECD. Greater internal uniformity within the guidance promulgated by the OECD also should lead to greater uniformity in the approach taken by all tax authorities. Therefore, explicit recognition of this guidance in all situations, not only business restructurings, should be lauded.

29. Similarly, the existence of local market comparable entities should be made a threshold question. Once the existence of reliable local market comparables is established, much of the potential analysis regarding location savings should be deemed unnecessary because any follow-up analysis will already be addressed in the application of those comparables. In short, reliable local market comparables internalize and in themselves account for location savings

and any other local market features. Therefore, it is suggested that the last sentence of paragraph 4 be strengthened to read: “Thus, where reliable local market comparables are easily available and can be used to identify arm's length prices, specific comparability adjustments for locations should not be made.” Recognition that comparables may be easily obtained is important. Furthermore, the change from “required” to “made” makes a more dynamic statement regarding the proper application of the arm's length standard in this context.

30. The first enumerated issue in paragraph 3 raises the question of whether location savings exist. The second enumerated issue raises the question of the amount of any location savings. The third enumerated issue in paragraph 3 raises the question of whether location savings are passed onto third-party customers or retained by the MNE. The fourth enumerated issue raises the question of how location savings should be allocated among members of an MNE.

31. As currently written, paragraph 4 implies that local market comparable entities only addresses the fourth enumerated issue raised in paragraph 3. While local market comparables certainly do address how location savings should be allocated between related parties, the importance and reach of local market comparables should not be limited to only this issue. Indeed, local market comparables will naturally incorporate all of the issues enumerated in paragraph 3. Local market comparables provide the most reliable indication of how profits generally should be split between affiliated entities. This indication applies not only to location savings but to all profits. Therefore, the extent location savings make up those profits is moot so long as the profits are properly allocated. In light of the foregoing, taxpayers and tax administrations should not devote their limited resources to determining the existence of location savings and quantifying them when local comparables exist. Therefore, we respectfully suggest that paragraph 4 be amended to make clear that existence of local market comparables should be a threshold issue, which, if comparables exist, should forestall all further location savings analysis.

32. In sum, the Revised Discussion Draft embodies a great accomplishment in addressing the topic of location savings. The Revised Discussion Draft's analysis and conclusions are fair, correct, and should provide both certainty to taxpayers and help tax authorities better allocate their limited resources. Therefore, more explicit and robust guidance in this matter, as described above, is welcomed to help ensure uniform application of the arm's length standard.

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On behalf of the global network of PwC Member Firms, with the contribution of our colleagues Richard Collier, David Ernick, Kathryn O'Brien and Aamer Rafiq, we respectfully submit our response to the Revised Discussion Draft on Transfer Pricing Aspects of Intangibles. For any clarification of this response, please contact the undersigned or any of the contacts below.

Yours faithfully,

Adam M. Katz
Partner
PricewaterhouseCoopers LLP, New York

Isabel Verlinden
Partner
PricewaterhouseCoopers, Brussels

PwC contact	Email
Adam Katz	adam.katz@us.pwc.com
Richard Collier	richard.collier@uk.pwc.com
David Ernick	david.ernick@us.pwc.com
Kathryn O'Brien	kathryn.obrien@us.pwc.com
Aamer Rafiq	aamer.rafiq@uk.pwc.com
Isabel Verlinden	isabel.verlinden@pwc.be