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By email

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Our ref	Tel	Fax	Date
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Dear Mr Owens

**Transfer Pricing Aspects of Intangibles
Project Scoping**

We are pleased to contribute to the scoping of a possible OECD project on the 'Transfer Pricing Aspects of Intangibles', following the OECD's announcement of 2 July 2010.

As acknowledged in Chapter VI of the existing Transfer Pricing Guidelines, intangible assets are often internally generated, unique in nature and highly important drivers of value. This means that firstly, identification of intangibles is extremely important and secondly, reliable comparables on which to base the pricing of transactions involving intangibles may not exist. This can in turn lead to divergent views and protracted disputes between tax payers and tax authorities.

Therefore, this project will provide a welcome opportunity to share views on this subject and to seek consensus on key principles and approach.

In terms of the specific questions asked:

1. *What do taxpayers see as the most significant issues encountered in practice in relation to the transfer pricing aspects of intangibles?*

Many of the issues identified during the OECD's review of Chapters I-III of the Transfer Pricing Guidelines are equally applicable to the transfer pricing aspects of intangibles.

The most significant issues encountered in practice include:

- a) **Recharacterisation of transactions** - Transactions concerning intangibles may be carried out between both related parties and unrelated parties for wholly commercial reasons. In related party situations, greater certainty that the form of such transactions will be respected by tax authorities is essential to allow clear, unfettered decision making. The threat of recharacterisation whenever there are no direct comparables (as is often the case with unique intangibles) is viewed as a significant blocker to corporate activity and growth and its use needs to be limited to exceptional circumstances lacking any commercial basis. This requires the OECD to offer guidance on the proper analysis of realistically available options in the context of integrated MNC's. Other than in the most extreme cases, disputes should be settled through pricing adjustments as economic theory should allow models to be designed to value all assets, including intangibles.

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- b) **Asset and asset transfer recognition** – Linked to the risk of recharacterisation, the issue of asset identification and transfer recognition is extremely important and can often be the first point of dispute. Guidance on the following fundamental questions would be extremely helpful, leading to an agreed framework and principles with which to answer them:
- o What is an intangible? (and by association, what isn't an intangible)
 - o When does an intangible exist?
 - o What are the characteristics of an intangible?
 - o Who owns the intangible? (including consideration of both economic and legal ownership)
 - o What rights does the intangible give to the owner of it?
 - o Does the intangible drive price, volume or both and what are the implications of this?
 - o When is an intangible transferred?

Further discussion and examples of the concept of 'marketing intangibles' would be very useful to enhance Part D of Chapter VI of the Transfer Pricing Guidelines.

In all but the most extreme cases, assets should not be 'created' by tax authorities through the bifurcation of tax payers' commercial arrangements. Instead, commercial substance and legal form of commercial arrangements should be respected as a whole and taxed accordingly.

- c) **Hindsight** – Although this is explicitly stated in section 6.32 of the Transfer Pricing Guidelines, it should be re-iterated in this project. Any tax authority analysis of intra-group behaviour should be based solely on the facts available at the time of the transaction and not on subsequent performance or market conditions, which would have been unknown or unknowable to the taxpayer at the time of the original transaction. At arm's length, bargains are struck based on best known information at the time, without mechanisms for wholesale price adjustment depending on actual future performance. At arm's length, uncertainties are accommodated through royalties, deferred consideration or milestone payments and generally not by revisiting the transaction. This is particularly the case when the transaction involves intangibles and even more so when intangibles are transacted during development.
- d) **Secret comparables** – The practice of alleging comparables based on non-publicly available data is a key concern to tax payers. Such behaviour undermines the spirit of co-operation and consensus that tax payers are seeking to establish and makes rational debate around pricing matters impossible either between taxpayers and tax authorities or between tax authorities in MAP proceedings.
- e) **Valuation of intangibles** – The method of valuation of intangibles is also an area that can lead to dispute. OECD guidance should draw attention to and endorse generally accepted methodologies for the valuation of intangibles, including discounted cash flow methods, in order to establish consistency of approach by tax authorities and tax payers. Also, guidance around the circumstances in which different valuation methods are (or are not) appropriate would be well received.
- f) **Consistency of interpretation and application of guidance** – It is extremely important that any published guidelines have consensus amongst both tax payers and tax authorities. Clearly this will be a challenging objective but without it, protracted disputes are likely to continue to arise.

2. *What shortfalls, if any, do taxpayers identify in the existing OECD guidance?*

Whilst the existing OECD Guidelines go some way to addressing the fundamental questions and perceived shortfalls noted in section 1 above, additional, consensus led, worked examples to support the guidance would be extremely useful.

Further, the existing guidance in Chapter VI refers to commercial intangibles including the two categories of trade and marketing intangibles. OECD should explore whether there is a more useful framework for the identification and classification of intangibles.

Summarising section 1, clarity on identification, ownership, the incidence of transfers of intangibles and valuation methodologies are all areas for improvement on the current guidance.

3. *What the areas are in which taxpayers believe the OECD could usefully do further work?*

The key areas in which the OECD could do further work are set out in Sections 1 and 2 of this letter.

4. *What do taxpayers believe the format of the final output of the OECD work should be?*

Having one set of Transfer Pricing Guidelines is extremely helpful. Therefore the final format of the output should be an update/extension of Chapter VI of the existing Guidelines, rather than a separate release.

We appreciate the opportunity to present these views and look forward to making further contributions to the project as it develops.

Yours sincerely



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