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2, rue André Pascal
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Re: Reply to the Invitation to Comment on the Scoping of the OECD's future project on the Transfer Pricing Aspects of Intangibles

Mr. Owens,

Barsalou Lawson is Canadian law firm specialized in corporate taxation for multinationals doing business in Canada, with a particular emphasis on transfer pricing. We are regularly involved in discussions regarding the intellectual property aspects of transfer pricing with the Canada Revenue Agency ("CRA").

We would first like to take this opportunity to congratulate the OECD in its final implementation and incorporation into its Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("Guidelines") of the results of its long and fruitful discussions on business restructurings and comparability issues. Barsalou Lawson also commends the OECD's intention to continue to expand guidance in the area of intangibles and is pleased to have this opportunity to reply to the OECD's invitation to comment on the scoping of its future project on the transfer pricing aspects of intangibles, dated July 2nd, 2010.

Our comments, which are summarized below, are limited to suggestions that relate solely to the Guidelines.

A. Most Significant Issues Encountered in Practice in Relation to the Transfer Pricing Aspects of Intangibles

1. Marketing Intangibles

In our experience, one of the most pressing issues in Canada with respect to intangibles is the application, in a fair and predictable manner, of the concept of "marketing intangibles." Taxpayers and tax authorities are regularly at odds as to the meaning and scope of "marketing intangibles" – a situation that may be exacerbated by the differences in understanding between the various tax authorities worldwide.

In Canada, for instance, we note that the CRA uses the concept in an attempt to attribute non-routine returns to local affiliates that perform local selling and marketing activities, even though all or essentially all legally-protected intellectual property (as this term is usually understood in Canadian law) is owned by foreign related entities. The legal basis for this is unclear. We are not aware of any legislation or jurisprudence in Canada endorsing the concept, much less defining it in a reasonably predictable manner. Commentators in Canada have, in fact, disputed the very existence at law of a local marketing intangible separate from the trademarks and trade names of the foreign entity, in part because it bears no hallmarks of a property that can be exploited for profit.

It is our understanding that the tax authorities of many countries are also in the process of expanding their definition of marketing intangibles as a "catch-all" in transfer pricing audits, without a clear framework for limitation or inter-jurisdictional consistency.

2. Treatment of Synergies and Other Undefined Elements of Goodwill

Separate from the issue of marketing intangibles, another significant issue encountered in practice is the risk of under-valuation or over-valuation of the intangibles as a direct result of the treatment of synergies and other undefined elements of goodwill in the context of the sale of one or more identified intangibles (*i.e.,* in the context of the initial purchase of a business from a third party, immediately followed by the sale of one or more identified intangibles to a foreign related party).

In some cases, it may be reasonable for taxpayers to rely on a valuation or purchase price allocation report to assist them in determining the correct transfer price for certain identified intangibles underlying the purchase of bundled assets or shares. In other instances, taxpayers may find there to be insufficient information in such a report to determine an arm's length price for the identified intangibles subsequently sold to a related party.

B. Shortfalls in Existing OECD Guidance

1. Marketing Intangibles

Our comments relate more specifically to local marketing intangibles that tax authorities, including the CRA, have a tendency to attribute to local distribution entities.

In Canada, the local affiliates of multinational enterprises usually participate to varying extents in local selling and marketing efforts related to the products they sell. In some instances, non-Canadian affiliates develop and prepare core marketing materials for worldwide use, which are then adapted and implemented locally by the Canadian affiliate. In others, the Canadian company has more involvement over marketing activities.

Some jurisdictions (*e.g.,* the US) attempt to define "marketing intangibles" in regulations, administrative positions or otherwise in public communications. Canadian law does not in our view recognize this as a stand alone legal concept and although the CRA has made brief references in its Information Circular 87-2R repeating some of the comments found in the Guidelines, such comments remain administrative in nature. On audit, CRA positions may include attempts to attribute non-routine returns to local affiliates that perform local selling and marketing activities even where all or essentially all legally-protected intellectual property is owned by foreign related entities. CRA may also seek to disallow the payment of royalties, irrespective of legal agreements in place, on the basis that the value of foreign-owned trademarks would have been economically enhanced in Canada by the activities of the local affiliate. In such instances, the lack or clear definitions as to what constitutes intangible property and the use of undefined terms such as "marketing intangibles" cause confusion and tend to fuel rather than prevent the occurrence of controversies on audit.

Paragraphs 6.36 to 6.39 of the Guidelines currently provide a brief analysis, by way of example, of the impact of marketing activities undertaken by enterprises not owning trademarks or trade names. However, current OECD guidance may be perceived to fall short in a number of ways, most of which are related directly to the absence of clarity as to the true nature and definition of a "marketing intangible" and the reasonable parameters of using the concept to attribute additional profits to local distribution entities. Among other things, whether this concept is meant to extend beyond intellectual property or other intangibles protected in domestic laws would need to be discussed and clarified.

We acknowledge that the fact-dependent nature of the analysis of intangibles in general makes it very difficult to distil into useful guidance. As with business restructurings, however, we believe that further guidance would be constructive and could be expected to improve inter-jurisdictional homogeneity. We are confident that the OECD can provide a framework for the

analysis of intangibles, including guidance as to how to differentiate between routine and non-routine local intangibles.

Below, we expand upon specific improvements that could be made in clarifying the nature of marketing intangibles, how local marketing intangibles are created and how value can be determined.

a. The nature of marketing intangibles

The current Guidelines and OECD publications are not sufficiently clear as to the nature or definition of "marketing intangibles". In jurisdictions that have no pre-existing concept of the term or that have different understandings of the value inherent in marketing activities, this can cause uncertainty.

Greater clarity could be achieved by defining whether the concept of "marketing intangibles" can and should constitute a distinctive type of legal or notional property beyond trademarks or trade names, copyrighted material, customer lists, distribution channels, and unique names, symbols, or pictures that have an important promotional value for the product, service or enterprise concerned.

It could also be beneficial to elaborate upon the relationship between goodwill and marketing intangibles.

b. The creation of marketing intangibles

It is not clear from the current OECD guidance the extent to which an activity in a local jurisdiction will give rise to a marketing intangible and what type of intangible property this might represent (if any) under domestic law, nor which additional considerations are most pertinent in the determination of the existence of such intangibles (*e.g.,* who made the decision to develop or enhance the value of the intangible locally, who managed the risks of that decision, who provided the services, who bore the costs). Even if there is agreement on what may lead to the creation of local "marketing intangibles", it would be helpful to bring the analysis beyond simply enumerating relevant criteria and to provide a clear definition of each such criterion.

For example, the determination of who "bears the cost" of marketing activities, following paragraph 6.38 of the Guidelines, could be subject to broad or narrow interpretation. The OECD may ultimately determine that it is sufficient, in order to avoid the inadvertent creation of local marketing intangibles, for there to be a legal contractual obligation to compensate or reimburse certain marketing activities, or a transfer pricing policy or method that is followed and has the same effect (*e.g.,* a policy that insulates the local distributor from losses arising from such expenses). If so, then greater predictability would result from a clear statement to this effect within the context of the Guidelines.

Furthermore, it may be beneficial to include more specific examples of when local non-routine "marketing intangibles" are or are not considered to have been created by a local distributor. If the intention is to refer to items such as reputation or other elements of goodwill that may be created, the OECD may consider using them as examples and indicating whether such intangibles would be considered routine or non-routine in the context of the examples.

It would also be helpful to update paragraph 6.37 of the Guidelines to cover situations where the local distributor is not an agent. For example, where a distributor is compensated by the foreign affiliate for local marketing services (and therefore not exposed to the risk of material loss that would result from a failed product launch, be it through an undertaking to reimburse specific expenses or else through the effect of a consistently applied transfer pricing policy), the conclusion should be that the distributor would not be entitled to share in any return attributable to the marketing intangible.

c. Determination of the value of marketing intangibles

It is not clear how value could be attributed to something that is not subject to ownership and therefore cannot be sold to a third party. Further, the contractual arrangements between parties should always be examined as they may already provide for compensation in the event of the termination of the arrangements and otherwise sufficiently deal with intangible rights.

In addition, some taxation authorities have taken the position that even though agreements entered into between a local company and its foreign affiliate specify that all intangibles are owned by the foreign affiliate, some of the returns on those intangibles should nevertheless go to the local distributor. Without clear examples of uncontrolled comparable companies who have permitted a third party to obtain a stake in their intangibles in this manner, any such analysis may result in an arbitrary attribution of profits.

It may be helpful to remind tax authorities that they should exercise restraint in overstating the value of local marketing intangibles of a distributor relative to the intangibles developed and owned by foreign affiliates of the MNE.

It is likely that some of the difficulties in the valuation of such intangibles will self-resolve as greater clarity in the definition, nature and creation of the notion of "marketing intangibles" is achieved. For example, where no such non-routine local marketing intangibles are found to exist, it will not be necessary to determine the value of such local marketing intangibles.

2. Treatment of Synergies and Other Undefined Elements of Goodwill

While Chapter IX provides a certain level of guidance regarding the treatment of synergies and an excellent summary of many of the difficulties encountered in practice with respect to this issue, it may be beneficial to bring forth a more detailed analysis that will provide taxpayers and

tax administrations with practical guidance on dealing with such difficulties, specifically as they relate to the transfer of intangibles.

C. Areas in Which the OECD Could Usefully Do Further Work

1. Marketing Intangibles

The extended concept of "marketing intangibles" adopted by many OECD tax authorities goes beyond the traditional areas of trade-mark, trade names, and customer lists, distribution channels, symbols and pictures described in the Guidelines at paragraph 6.4. This extension poses challenges with respect to their analysis for transfer pricing purposes.

If the OECD is able to provide additional guidance in this area as well as address the issue of inter-jurisdictional differences in the application of the concept of marketing intangibles in assessing transfer prices, substantial progress could potentially be made in improving predictability for taxpayers.

We respectfully submit that the scope of the OECD's future project on the transfer pricing aspects of intangibles include the following general objectives, supplemented as appropriate by the specific suggestions outlined in the above sections:

- Providing a framework for analysis of marketing intangibles, with specific emphasis on local marketing intangibles, including clarification of the nature and creation of local marketing intangibles and the determination of value of those intangibles;
- Providing guidance on how to distinguish between routine and non-routine local marketing intangibles; and
- Providing further examples for illustrative purposes, including both when local marketing intangibles are or are not considered to have been created, thereby providing better-defined parameters of when transfer pricing adjustments may or may not be appropriate.

2. Treatment of Synergies and Other Undefined Elements of Goodwill

Guidance would ideally lay out a framework for analyzing how synergies and other undefined elements of goodwill are best measured and attributed to the related buyer and seller of certain identified intangibles (*i.e.,* subsequent to the purchase of shares or bundle of assets from an unrelated party).

In some instances, goodwill may be further analyzed into component parts that are determined to be likely to follow the identified intangibles or else likely to remain with the seller. However, in other cases, some or all of the goodwill may not be capable of being further refined in such a

manner; it may be pertinent to question whether an objective arm's length allocation could or should be recommended to overcome this hurdle.

In the event that component parts have been identified, it may be pertinent to elaborate a non-exhaustive list of factors that may impact the determination of whether the seller's compensation should include the value of part or all of the goodwill, including the portion of goodwill that may represent synergies. In this respect, we would be pleased to contribute to the elaboration of such a preliminary list.

Although beyond the scope of any work that would be undertaken by the OECD, it may be helpful to draw attention to the fact that the tax treatment of such undefined elements of goodwill, and included in the purchase price paid by the related party, may not be the same in the country of the purchaser and the country of the seller.

Helpful examples could include analysis of a scenario where the intercompany transfer of identified intangibles immediately follows a recent acquisition of the company from a third party, and a valuation or purchase price allocation report was issued in the context of that transaction. Such an example could be used to explore the utility and limitations of such a business valuation report in determining an arm's length price for the identified intangibles and how a specific transfer pricing analysis could address these challenges.

D. Format of the Final Output of the OECD Work

1. Marketing Intangibles

An initial discussion paper on marketing intangibles could be an appropriate first step to pursue dialogue with the business community, but we would suggest that the Guidelines eventually be updated with the more detailed policy views and opinions that will inevitably result from the OECD's project on the transfer pricing aspects of intangibles.

For ease of reading, the other areas of the Guidelines that discuss marketing intangibles could also be cross-referenced and, as appropriate, elaborated upon in a new chapter covering intangible property.

2. Treatment of Synergies and Other Undefined Elements of Goodwill

Regarding the treatment of synergies and other undefined elements of goodwill, an appropriate final output could take the form of more elaborate guidance and examples in a new chapter dealing with intangibles, with cross-references as appropriate to the existing guidance in the new Chapter IX on business restructurings.

Barsalou Lawson[*] would be pleased to elaborate upon any of the comments and ideas raised in this submission, should the OECD decide to further pursue such suggestions.

[*] *Barsalou Lawson's reply has been prepared by Sebastien Rheault, Pierre Barsalou, Sheena Bassani, McShane Jones and Travis Chalmers*