

15 September 2010

Dear Ms. Levac,

BIAC appreciates the opportunity to provide input on the scoping for a new WP6 project on the Transfer Pricing Aspects of Intangibles. BIAC's membership strongly supports the arms-length standard and the guidance provided by the OECD Transfer Pricing Guidelines, and we believe it is critically important that the intangibles project, if approved, be conducted within this established and well-respected framework. BIAC seeks a framework which avoids double taxation.

Economic and business model changes over the past several decades have increased the importance of intangible property and it is important that the OECD Transfer Pricing Guidelines are updated as appropriate to reflect these changes. The OECD Committee on Fiscal Affairs (CFA) and its Working Parties have already done important work in this area, including the reports of the various Technical Advisory Groups (TAG) on e-commerce, the OECD Model Tax Convention Article 12 commentary on computer programs, the recently completed work related to the Model Tax Convention Article 7 and Article 9 and revisions to the OECD Transfer Pricing Guidelines with respect to business restructurings.

BIAC believes that the proposed project on intangibles should take full advantage of this previous work, which provides important guidance for the transfer pricing of many transactions involving intangibles. We also believe that the current Chapter VI, Special Considerations for Intangible Property, provides useful guidance for many transactions involving the more traditional intangibles (e.g., patents, copyrights, trademarks). We have sought to emphasize the areas which are adequately dealt with in previous OECD guidance.

Many business transactions between unrelated parties involve intangible property, including licensing, joint venture arrangements, distribution agreements, contract manufacturing, and the acquisition of the whole or part of a business. These transactions, including the intangible components, are routinely valued and priced based on the free market. Financial accounting rules may require the allocation of value to identifiable components of a transaction, including the intangible components. These transactions, however, often assign aggregate values to intangibles and do not allocate these intangible values to specific

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operating units or geographies within the participating enterprises. Intercompany allocation between geographies and affiliates is an important requirement to support intercompany transfer pricing for multinational corporations and BIAC believes that the proposed intangibles project should focus on this aspect of intangibles. We believe that additional guidance in this area will help reduce transfer pricing disputes and reduce the incidence of double taxation, and this belief guides our responses to the four questions being posed in relation to this project, as outlined in your letter to BIAC dated 28 June, 2010.

You will find as follows BIAC responses to these questions.

BIAC notes that in commenting on the scope of the project and the significant issues to be addressed, we have been influenced by the proposed timeline for the project. As a result, our comments are not a comprehensive list of all issues and areas of uncertainty, but focus on the significant issues which we believe can be addressed within the timeline. This does not preclude the discussion of other issues if it is practical to include these within the project.

We will be pleased to answer any questions you may have concerning the BIAC comments

Sincerely yours,



Chris Lenon

Chairman, BIAC Committee on Taxation and  
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## **BIAC Responses to the OECD Questions for Purposes of Scoping an OECD Project on Intangibles**

### **I. What are the most significant issues encountered in practice in relation to the transfer pricing aspects of intangibles?**

We believe the significant issues are:

- Identifying the transactions involving intangibles which are compensable for tax purposes
- Determining the appropriate amount of compensation for tax purposes
- Clarifying the relevant party entitled to earn income attributable to the intangible
- Determining an appropriate valuation approach for tax purposes

The objectives of valuation for transactions between independent enterprises, and for financial accounting purposes, are fundamentally different than the objectives for intercompany transactions. BIAC believes that this additional requirement for intercompany transfer pricing is most significant for items such as non-legally protected intangibles such as workforce-in-place, goodwill, and certain marketing intangibles such as customer lists and customer base. These intangibles are often valued on an aggregate basis in the residual category for independent business transactions, creating the potential for significant uncertainty with respect to both (i) identification of those transactions which may be compensable and (ii) determination of the appropriate compensation for transactions between affiliates that may involve one or more of these intangibles.

Determining the relevant parties who are entitled to earn income attributable to these items of intangible property for transfer pricing purposes is also a most significant issue that would benefit from additional guidance in the Transfer Pricing Guidelines. While determining the relevant parties who are entitled to earn income attributable to these items of intangibles for transfer pricing is relevant for transfers of all intangibles, and we would expect that additional guidance may impact the broadest category, we believe that the need for guidance is most acute in the area of the sub-category of intangibles as noted above.

BIAC believes that existing OECD guidance is adequate for many transactions involving intangible property and we would recommend that the following intangibles transactions not be a primary focus of the intangibles project if it is approved:

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- Transactions in intangible products such as computer programs, digital music, digital books, digital video and e-commerce in general as these transactions are adequately addressed in the Article 12 Commentary on computer programs and the e-commerce report, produced by the OECD Revenue Characterization TAG.
  - Services transactions that include an element of intangible property, such as professional, technical or marketing services, as these transactions are adequately addressed in the current OECD Transfer Pricing Guidelines.
  - Transactions, including cross-licenses, in traditional (legally protected) intangibles such as patents, copyrights, trademarks, etc. which benefit from adequate comparable transactions and existing transfer pricing mechanisms.
  - While the concept of the relevant parties who are entitled to earn income attributable to these items of intangibles based on the function they perform was evaluated in the business restructuring project, paragraph 9.21 of the Report on the Transfer Pricing Aspects of Business Restructuring clarifies that the functional analysis under Article 7 is not intended to set a standard under Article 9 because the analytical framework under Article 9 is different from the AOA under Article 7 so we would not expect that the concepts relating to attributing income from these items according to the performance of “significant people functions” will be relevant for this intangibles project.

It might be thought that “intangibles” arising from “best practices” should be addressed in the project. BIAC does not propose this, firstly because the amounts involved are not significant, and secondly, because the compliance burden would be disproportionate to the tax outcome.

In addition, we believe that any work on cost contribution arrangements should be limited and must focus on achieving valuation methodologies consistent with the rest of the project.

We look forward to feedback from WP6 regarding its current view of the “most significant issues” in the intangibles area.

## **II. What shortfalls, if any, we can identify in the existing OECD guidance?**

The BIAC working members have identified the following shortfalls in the existing OECD transfer pricing guidance for intangibles.

We would note as a general comment that the difficulties of identifying compensable items of intangible property and their respective capacities for producing taxable income often lead to imprecise valuations, which may be driving the controversy around intangible transfers and licensing. Given that such imprecision and difficulties are inherent in the application of the

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arm's length standard, efforts by the OECD to provide broader albeit less precise guidance should be a goal to improve the Guidelines.

Our comments below are approximately listed in order of importance to the members of BIAC.

- Lack of description of which intangibles or other attributes are not compensable for transfer pricing purposes. Currently, there are no explicit guidelines that exclude certain future profit potential attributes which may be considered intangibles for other non-tax purposes, such guidance would be useful. Examples, in some contexts, may include:
  - Future profit potential
  - Risk bearing activities
  - Goodwill
  - Going concern
  - Workforce-in-place
  - Network intangibles
  - First mover advantage
  - Economies of scale
  - Barriers to entry
  - Superior management
  - Group network attributes which no one member may own
  
- The lack of guidance on determining what member or members own all or part of a group wide intangible such as trademark, patent, or network intangibles.
- The lack of guidance that application of the arm's length standard does not require close proximity with actual third party behaviour, e.g., the licensing of unique intangibles to third parties.
- The lack of guidance on how valuation methods applied for non-tax purposes in valuing intangibles can be applied and to what extent for transfer pricing purposes.

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### III. In what areas can OECD usefully do further work?

The BIAC working members have identified the following areas where the OECD could undertake to further the usefulness of the transfer pricing guidelines as applied to intangibles.

- Provide more guidance on how the arm's length standard would apply to the intangible issues identified in BIAC's responses to questions 1 and 2 including examples where compensation would and would not be appropriate, i.e., whether an intangible gives rise to a compensable transaction.
  - Clarify and identify the difference between, for example 1. "soft" intangibles that may not be subject to or require compensation and 2. recognized intangibles for which the Guidelines have been reasonably adequate.
  - Clarify issues which have led to tax controversy among tax administrations and taxpayers about the identification and compensation of transfers of intangibles.
- Provide more guidance on certain arm's length transfer pricing (valuation) models for the transfer of intangibles that tax administrations and taxpayers have generally recognized as subject to transfer pricing analysis with emphasis on adjustments required (if any) to account for the related party nature of the transaction. The existing transfer pricing valuation methodologies are not comprehensive in providing guidance for this area.
  - Discussion on what arm's length valuation models may be used for tax purposes.
  - Discussion on differences in the appropriateness of valuations performed for financial statement purposes as compared to transfer pricing reporting.
  - Discussion on risk bearing and further clarify that risk bearing is not the same as an intangible.

### IV. Which format should the final output of the OECD work take?

Business seeks greater certainty in the treatment of intangibles from a transfer pricing perspective from the proposed project. In particular (and in common with a primary aspiration in transfer pricing issues) we seek a framework which avoids double taxation.

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This framework would best be served by a revision to the Transfer Pricing Guidelines in the commentary on Article 9, because this provides the highest level guidance on treatment which is needed in this area of complexity. We have discussed whether the approach to follow should be principle or rule based – different OECD member countries use different approaches and will therefore be more supportive of different approaches with the result that achieving a meaningful consensus may be difficult. For any revision to provide a practical framework for business, it must be built on consensus. Business therefore proposes that the project should focus on developing principles for the treatment of intangibles however, these principles will need to be developed with additional guidance including examples to ensure consistent treatment by tax authorities.

We have considered whether we should provide details of which issues could be best dealt with by examples. On reflection, we believe that it would be more beneficial to focus on this after the first intermediate reports on the scope of the project.

In terms of process to achieve the optimal final output, we would again emphasise the benefit of the OECD and member governments working in partnership with BIAC to achieve an outcome which provides practical guidance which can be used to resolve disputes between tax authorities and avoid double taxation.