Grant Thornton Société d'Avocats
Avocats à la Cour

**Jeffrey OWENS**
**OECD**

Paris, 15th September 2010

Dear Mr. Owens,

Please, find hereafter our comments as regard to the OECD project of transfer pricing aspects of intangibles.

## 1 – Concerning the qualification of IPs

We believe that the qualification of IPs is a big matter of concerns because some companies (related or not) can deal each other disregarding the exploitation of IPs developed by one of them but which is not perceived due to the lack of factual and legal analysis. In this respect, one can observe a significant imbalance of profits when parties deal each other on IPs that they failed to qualify. This can lead to various situations whereby arm's length prices of tangible goods are not satisfying and do not allocate arm's length profits throughout the group because some IPs derive significant profits and are not identified. We would like to draw the attention of the OECD that one indicative issue of non qualified IPs is an inappropriate allocation of profits in the group consisting either on large profits located in similar type of profile of member group companies or persistent losses in the company developing the IPs.

Beside, one can observe that tax authorities tend to identify IPs in many cases, justified or unjustified, maximize their tax collections. The analysis can be insufficient as it is merely focused on one entity while we believe it should be done at a larger extend, to the context of the group for identifying those similar profiled companies showing an excess of profits and this company showing development activities and suffering from recurrent losses.

As a result, it seems to us that the identification of IPs requires an analysis made at the group level but not at a company level to reach a relevant demonstration.

## 2 – Identification of IPs and examination of group TP policy

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The paragraph 3.18 of the OECD Guidelines (July 2010) provides that : "*The choice of the tested party should be consistent with the functional analysis of the transaction. As a general rule, the tested party is the one to which a transfer pricing method can be applied in the most reliable manner and for which the most reliable comparables can be found, i.e. it will often be the one that has the less complex functional analysis*". Indeed, it is widely recognized in a transfer pricing study that the tested party in a transaction should be the one performing the simplest functions, bearing the lowest risks and owning no valuable intangibles. This approach is intended to provide greater reliability in comparing the tested party to comparable companies and greater chances to find similar type of company.

For those companies exploiting valuable intangibles, routines activities should be separated from profits resulting from the exploitation of such IPs to achieve a reliable measure of the remuneration of their routine activities. This means that one should observe an excess of profits once routine functions are benchmarked, this excess of profits can then be interpreted as an indicative issue of IPs exploited.

One can observe in tax audits, some tax authorities pretending to the presence of valuable IPs in the audited company which they do not identify nor assess an additional profit, while they also accept and recognize the appropriateness of the conclusions of a transfer pricing study benchmarking the overall profits of the audited company. It seems that if overall profits were benchmarked and if the transfer pricing study is acceptable to tax authorities, there is no real non routine intangible to remunerate.

By the opposite, the identification of IPs could be deduced from an excess of profits after remunerating routine functions at arm's length. The identification of IPs could also result from significant losses for a developer which did not succeed to market the outcome of its research activities locally although this is successfully done in another country by a related company.

We believe that the OECD could clarify the Guidelines on those points by reinforcing the meaning of benchmarking studies in the profitability analysis of a company suspected of owning or using IPs in its business. It would also be necessary to clarify that the detention of IPs cannot be deduced on the sole profit/functional analysis of the audited company but requires wider examinations.

**3 – Central purchasing**

Some groups organize their business so as to reduce redundant functions and to create a greater power of negotiation by centralizing their purchasing functions into a single company. Although this greater power of negotiation can be achieved thanks to the growing volumes resulting in the centralization of the purchases, some tax authorities consider that this can result from a specific know how of the team which helps to achieve the real economies of scale. These central purchasing can merely operate as service providers and their clientele only composed of related companies.

We believe that the OECD could helpfully clarify the Guidelines for such specific functions and goodwill valuation while these are only dedicated to a group.

Henry Godé

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