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By email

Dear Mr. Owens

Suggestions on Scope of Possible Project on Transfer Pricing Aspects of Intangibles

Mayer Brown welcomes and appreciates Working Party N°6's (the "**Working Party's**") invitation to submit topics for inclusion in its possible project regarding the transfer pricing aspects of intangibles.

It has been our experience that conflicts in this area arise between taxpayers and tax authorities, and between tax authorities themselves, because of fundamental differences of views on such questions as the identification, ownership, and valuation of intangibles (very often as bound up with other types of transactions).

The current versions of Chapters VI and VIII of the Transfer pricing Guidelines (the "**Guidelines**") address aspects of each of these questions to some degree, and we believe that it is essential that the intangibles project, if approved, be conducted in the framework of the Guidelines. In particular, we would like to emphasize that, in our view, this project should be undertaken with two core principles in mind, consistent with the Guidelines: (i) the primacy of the arm's length standard and (ii) the principle of recognition of the actual transactions undertaken by the associated enterprises (as detailed under paragraph 1.64 of the Guidelines).

With this as background, we offer the following:

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

(a) Identification of compensable items of intangible property

Though the Working Party is undoubtedly familiar with the disputes between and among taxpayers and tax authorities with regard to what intangibles should be recognized as items of intangible property for which compensation would be due at arm's length, this issue is of signal importance.

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(b) Ownership of intangible property

Taxpayers and tax authorities often face challenging questions in practice as to how legal and economic interests in intangible property should be taken into account for transfer pricing analyses.

(c) Valuation of items of intangible property

The success of developing an intangible is difficult to predict; uncontrolled comparables are often absent for high value intangibles. This leads tax authorities to rely upon hindsight (in some way) to evaluate controlled intangible property transfers, which undermines the *ex ante* principle of the arm's length standard.

2. **In relation to these issues, what are the areas in which Mayer Brown believes the OECD could usefully do further work?**

(a) Identification of compensable items of intangible property

With regard to identifying compensable items of intangible property, we would encourage the Working Party to investigate the extent to which international disputes might be avoided by recommending that taxpayers and tax authorities focus not just on whether a certain class of intangible is transferrable, but also on how reliably a purported intangible can be shown to increase taxable income (in whatever manner, whether through an increase in revenue or a decrease in costs). Our suspicion is that some of the "soft" intangibles routinely claimed to be transferrable and compensable by tax administrators would fall short of this standard.

(b) Ownership of intangible property

With regard to ownership, we would welcome the Working Party developing an assortment of examples using common fact patterns, similar to the approach taken in Chapter IX of the Guidelines on business restructurings. It would be most helpful to have guidance on how ownership should be treated when legal and economic interests overlap in varying degrees.

(c) Valuation of items of intangible property

With regard to the valuation of items of intangible property, we would welcome the Working Party's consideration of several issues and controversial positions:

- (i) *Risk Bearing and Valuation*: To the extent that the Guidelines will be revised to address valuation uncertainties, we would recommend that the Working Party also address more broadly within Chapter VI the relationship between risk and valuation. For example, in this regard, it would be useful for the Guidelines to reemphasize the importance of recognizing contractual terms through which risk relating to the exploitation of an intangible can be transferred, thereby decreasing the consideration a risk-averse transferor would demand.
- (ii) *Discount Rates*: Discount rates are a critical component in the determination of the value of intangible property. Although the Guidelines now refer to net present value, there is no specific discussion on the selection of discount rates. Clearly, the choice of the appropriate risk-adjusted rate should be dependent on the facts and circumstances of each

case. Nevertheless, it would be useful for the Working Party to offer concrete examples or other guidance as to how appropriate discount rates should be determined in different cases.

- (iii) Pre- vs. Post-tax Valuations: Practitioners are at times confronted in practice with the view that arm's length valuations of intangible property should be done on a pre-tax basis. There is substantial legal and theoretical authority for the proposition that the arm's length price should be determined with reference to fair market value, which, in turn, is determined by reference to post-tax values. It would be helpful for the Working Party to comment on the position that the arm's length standard is consistent with valuations on a post-tax basis.
- (iv) The Characterization of a Controlled Taxpayer as an "Investor": It would be useful for the Working Party to address the scope and reliability of this model as a valuation principle. In particular, it would be worth elaborating on a set of principles under which tax authorities may characterise a controlled taxpayer in an intangible transaction as making an "investment", particularly outside of cost contributions / cost sharing arrangements.

3. Conclusion

Mayer Brown once again thanks the Working Party for soliciting practitioners' input in an area prone to double taxation controversies. Mayer Brown appreciates the opportunity to offer suggestions to the Working Party on agenda items for a possible project on the transfer pricing aspects of intangible property.

We hope that our suggestions are helpful, and we would welcome any requests from the Working Party as to how we could assist in facilitating its understanding of these important issues.

Yours sincerely,



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