THE CANADIAN
INSTITUTE OF
CHARTERED BUSINESS
VALUATORS

September 20, 2010

Sent via email to: jeffrey.owens@oecd.org

Mr. Jeffrey Owens
Director, Centre for Tax Policy and Administration
OECD
2, rue André Pascal
75775 Paris Cedex 16
France

Dear Mr. Owens:

Re: Comments on Scoping of Project on the Transfer Pricing Aspects of Intangibles

The Canadian Institute of Chartered Business Valuators (CICBV) is pleased to provide our comments on your contemplated project regarding the Transfer Pricing of Intangibles.

The CICBV is a sponsoring member of the International Valuation Standards Council - an independent international valuation standard setting organization - and is the largest professional business valuation organization in Canada, with over 1,300 Members. It is a self-regulated organization that, in addition to governing its Members with a strict Code of Ethics and Practice Standards, grants the Chartered Business Valuator (CBV) / expert en évaluation d'enterprises (EEE) designation. The CBV/EEE designation is recognized as the premier credential for professional business valuators in Canada. The vast majority of our Members hold professional designations in addition to the CBV/EEE, such as Chartered Accountant and Chartered Financial Analyst. In addition to providing a broad range of business valuation services to Canada's business, legal, investment, banking and government communities, our Members are also active in other areas, such as financial advisory services, transfer pricing advisory services, the quantification of economic damages, and business management.

Our Members are very involved in valuing intangible property in the context of the transfer of such types of property between Canada and other jurisdictions. The high quality of our member's work and the importance of the CICBV professional standards are recognized by the Government of Canada's taxation authority – the Canada Revenue Agency (CRA). CRA valuation staff are required by their internal operating manuals to follow the Practice Standards of the CICBV when completing tax-related valuation opinions relating to all assets and business interest, including intangible assets.

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The focus of our comments is on issues related to a determination of the value of intangible assets. A very important aspect of transfer pricing, in the context of the sale or transfer of intangible assets between jurisdictions, is the inextirpable link between the key elements of transfer pricing and the determinates of value. Reconciliation of these key elements of transfer pricing (i.e. license fees, royalties, etc) to intangible asset value is an essential part of this process.

The valuation of intangible assets is a complex exercise that requires the same high degree of rigor required of the valuation of a business or business interest. Fundamental to the valuation process is an understanding and assessment of such matters as the premise of value; the relevant economic factors; the relevant industry; the competitive environment; marketing; the legal and regulatory regime; financial analysis of past and projected earnings and cash flows; taxation; capital structure and required rates of return.

We have attempted to organize our comments to respond to the four questions posed by the OECD on its website.

What are the most significant issues encountered in practice in relation to the transfer pricing aspect of intangibles?

Business restructurings can involve the transfer and valuation of multinational enterprises' intangible assets in isolation, or alternatively, they can involve the transfer and reorganization of stand-alone corporate entities (holding the very same intangible assets). It is our suggestion that a valuation analysis should reconcile internally at certain points in the application of its selected methodology and that presently there are instances where, due to conflicting standards of value and undefined underlying assumptions, this is often not the case. An intangible asset value implicit in a corporate reorganization will often be different from the value to a potential arm's length acquirer. This valuation conflict is the result of the asset valuation being conducted under conflicting understandings of what constitutes "value".

What are the shortfalls with the existing OECD guidance?

We have itemized several of the more prominent challenges we have encountered in reconciling intangible asset valuations and transfer pricing analysis completed for tax purposes:

1. The definition and criteria for what constitutes an intangible asset is unclear;
2. What is the governing Standard of Value and what are the underlying assumptions supporting the standard;

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3. There is the potential for the tax migration of an individual intangible asset(s) to have the potential to be materially different from the same asset(s) transferred in a corporate structure;
4. What is the appropriate allocation of a company`s commercially transferrable goodwill to the value of its individual identifiable intangible assets, or alternatively, its subsidiary operations;
5. How does the value of an identifiable intangible asset reconcile to the present value of the future licensing or royalty payments – the future cashflow stream;
6. What is the appropriate perspective – top-down versus bottom-up, historic versus prospective - to be used in assessing valuation inputs such as; discount rate, free cash flow, transaction normalizations and the applicable tax rate.

What the areas are in which the OECD could usefully do further work?

Clarity around the appropriate "standard of value" would benefit transfer pricing analysis. The most frequent standards of value are fair market value, fair value and investment value (or value to owner). Taxation authorities have historically required a fair market value standard in the context non-arm's transfers of assets and businesses.

Underlying the fair market value standard is that the value determined must be viewed from the perspective of the highest price available between an informed market of arm's length parties. Some recent jurisprudence focuses on the fact that the arm's length assumption is being applied in a vacuum, without regard to the highest price obtainable or how a market of willing buyers might negotiate. More specifically, is value sought to a particular buyer, as compared to the population of willing (hypothetical) buyers.

Additionally, the assumptions of highest price and arm's length transactions also raise issues relating to market participant and company specific synergies and how they impact the valuation equation. What is the impact on a stand-alone intangible being migrated between tax jurisdictions? In considering the value of a stand-alone entity or asset, is the most likely buyer another larger, fully integrated multinational company and how would such an arm's length party value the expected future cash flows derived from the asset versus the actual parties to the real transaction.

Finally, the premise of value is somewhat unclear under the current OECD guidance. Namely, if the asset to be valued is approached under a going concern assumption – which inherently includes operational goodwill, how is such goodwill appropriately allocated amongst the assets, if at all.

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What format should the final output of the OECD work be?

The above items delineate some of the ongoing valuation challenges concerning intangible asset valuation and appropriate methodology. The OECD should consider establishing a uniform standard of value and the necessary underlying assumptions. This will provide a governing perspective on how intangible asset valuations should be completed and provide assistance as to how professionals can better navigate challenges such as those listed above.

We hope that our comments are helpful to you. It is our belief that input from members of the valuation profession will be an essential element of your considerations in this area. In this regard, we would be pleased to work with you further on this project.

If you have any questions regarding our comments, please do not hesitate to contact Robert H. Boulton, CA, CBV, our Director of Professional Affairs (email: boultonb@cicbv.ca).

Yours truly,

Gordon G. McFarlane, CA, CBV
Chair, Professional Practice and Standards Committee

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