September 14, 2012

BIAC Comments on the OECD Discussion Draft: Revision of Special Considerations for Intangibles in Chapter IV of the OECD Transfer Pricing Guidelines and Related Provisions

Dear Joe,

BIAC is pleased to respond to the OECD request to send comments on the Discussion Draft on the Revision of Chapter VI of the Transfer Pricing Guidelines published 6 June 2012 (hereafter referred to as "the Draft").

We provide more general comments in this document for each section of the Draft and separately provide a redline version of the Draft itself. We have limited our comments on the examples as we believe there are issues which we need to better understand before we can provide comments on the examples. We welcome the proposed consultation with business in November as a means of taking this forward and propose to provide additional comments on the examples, following the consultation.

The following are a number of general key concerns with the text. These are followed by points relating to sections A-D of the Draft. A redline is submitted separately.

- BIAC acknowledges that the topic of transfer pricing aspects of intangibles is an extremely complex and sensitive area and note the OECD work on base erosion and profit shifting (BEPS). We observe that substantial work has been done and generally support much of the commentary in the Draft. We recognise and welcome the fact that the Draft has been released as an “early draft”, even if as a result we have significant comments on some aspects of the drafting. For example, relating to the proposed definition and the functional approach proposed for the identification of the parties entitled to the intangible related returns; regarding the inconsistent and wide language used; the lack of cohesion between the examples themselves and the examples in the text; the lack of clarity around analytical process; and how to deal with license arrangements and when to bundle or unbundle transactions.

Mr. Joseph Andrus
Head of Transfer Pricing Unit
OECD Centre for tax Policy and Administration (CTPA)
We recognize that the Draft is not necessarily a consensus document and further work is required. We encourage OECD to continue and complete the work with an aim to reach consensus as the international tax community will greatly benefit from such agreement. Also in the event that the work will not result in a complete consensus document and reservations need to be made by certain countries, disclosure of such positions to the international tax community will have great value. We do reiterate BIAC’s general position that OECD guidelines are most valuable when the number of reservations is limited and that the more reservations there are the more difficult dispute resolution becomes.

We have concerns that the document can be read as assuming an anti-abuse standpoint. There is a concern that Profit Split as a method is overemphasised even where other better methods are available as arms length comparables and we believe that there is too much restatement rather than reference to existing guidance in the Guidelines. We would also suggest that a reference to a de minimis filter should be included to preclude a multiplication of issues where the cost benefit to both fiscal authorities and business will be unlikely. Furthermore we believe that the draft to a larger extent should aim at resolving the most common issues relating to the treatment of an intangible asset for transfer pricing purposes rather than the exceptional cases.

It is noted that the OECD Guidelines are globally the standard for dealing with intercompany transactions and the Guidelines are especially followed by member States, but also a significant number of non-member States follow them. To address application of the Draft for the non-member States, we encourage the OECD to interact with countries which are not OECD Members.

We are pleased with the acknowledgement of conditions or circumstances that do not constitute intangibles and are not compensable for transfer pricing purposes. Specifically, on group synergies and market specific characteristics we would appreciate guidance on the scope of further work proposed at ii) on page 3 of the Discussion Draft on the valuation of these issues and a timetable for this work.

We would also like to draw your attention to the fact that, as for any other transfer pricing matter, the analysis of the ownership, income deriving from the ownership and valuation of intangibles need to be articulated very precisely and need to follow a step by step process, which is sequenced as follows in the case of intangibles:

- Define if an intangible asset exists: we believe that as it is currently drafted, the Draft, as it defines an intangible as a “something” that has commercial value, is too vague and subjective and will not protect taxpayers as well as Member States. In order to avoid vagueness and appropriately recognise the treatment of intangibles in a third party situation, an intangible should be defined as an “asset” that is recognized by legal and accounting rules as being subject to ownership, control and transferability. In this connection, ownership of an intangible asset normally carries with it the right to earn
income from exploiting that asset, the right to exclude others from exploiting that asset to earn income and the right to transfer ownership or use of that asset to another.

- Determine which entity within a Group of companies has the ownership of such an asset and therefore be entitled to the intangible related returns.
- Assess the value of such an intangible asset in case of use by or transfer to another entity within the Group companies

- We would propose that generally following this process could assist in making the Guidelines more transparent and have specifically proposed a “decision tree” process in Section B. The Draft deals with both the use and transfer of intangible and it would be helpful to be more explicit about each concept as there are points where the two are dealt with together.

- Following this process will provide clarity and assist the international tax community to deal consistently with intercompany transactions involving intangibles. Our goal is indeed to minimise risk of double taxation by avoiding any unnecessary ambiguity on principles or lack of clarity of definitions and wording used. To this end, it would be welcome if the Draft could bring some clarity on the following items:
  - Legal and accounting principles and contractual arrangements shall be systematically used in order to assess whether or not an intangible asset exists;
  - Generally an entity cannot own an intangible for transfer pricing purposes if it does not simultaneously (1) own legal protection of the intangible (2) perform functions in relation to the ownership, the maintenance or the management of the intangible and (3) incur costs in relation to the intangible;
  - The existence of an intangible shall always be analysed in taking into account three cumulative elements: contractual arrangements, cost analysis, and functional analysis.

- We also would welcome confirmation that the Draft does not implicitly implement a "residual asset split" approach by mixing concepts such as the ownership of an intangible and an appropriate return on expenses incurred/functions performed (for example: a distributing entity which benefits from the right to use an intangible shall not be seen as the economic co-owner of the intangible, but may well be entitled to a certain level of income if its develops its own distribution intangible).

- As noted above, page 3 of the Draft states that “the transfer pricing consequences of various items treated in this draft as comparability factors rather than intangibles, including market specific advantages, location-based advantages, corporate synergies and workforce issues,” are among the issues to be addressed in later
drafts. This absence makes it difficult to assess the impact of the rules proposed in the discussion draft. Preliminarily BIAC expresses the concern that, without proper guidance on this subject, disproportionate values could be attributed to vaguely defined intangibles by analyses focusing too much on the above mentioned comparability factors. In order to prevent such issues BIAC suggests that when addressing this topic a number of steps be required before valuing any intangibles:

- Intangibles have to be clearly identified;
- They can be transferred to or provided for use by, another party; and
- They would be compensable in comparable dealings between independent parties.

The remainder of this paper will address more specific comments on sections A-D of the OECD Draft. These should be considered in conjunction with the BIAC redline comments submitted.

We will be pleased to answer any questions you may have regarding these comments, and the redline comments.

Sincerely yours,

Chris Lenon
Chairman
BIAC Committee on Taxation and Fiscal Affairs
Comments on Sections A-D and related examples in the OECD Discussion Draft

Section A: Identifying Intangibles

- Paragraph 3 of the Draft should reference Chapters VIII and IX of the Guidelines as well as Chapters I, II and III.

- Paragraph 5 suggest that the word “intangible” is intended to address “something” with is not a physical and financial asset and which is capable of being owned or controlled. We oppose such a vague definition, which we do not believe appropriately reflect the way intangibles are identified between independent parties as prescribed under the arm’s length principle. We therefore believe that the definition should refer to an intangible as being an asset which in addition to the cumulative requirement of being capable of being owned and controlled also should be separately transferable.

- Paragraph 7: Whereas BIAC agrees that some intangible may be transferred in combination with other intangibles, we believe an intangible would not exist when the asset does not have legal protection and where the asset is not transferrable separately. For example, under some circumstances and specific local legislations, a trademark cannot be transferred separately from the goodwill of the business associated with the trademark. Nevertheless, trademark rights can be licensed separately and the owner of the trademark can seek legal redress to exclude others from exploiting the trademark. We have grave concerns about recognizing a “something” as an intangible for transfer pricing purposes that is not subject to being transferred separately (or with goodwill) and that does not enjoy some level of legal protection.

- Paragraph 20 seems to state that all licenses are intangible, where it is not always the case. Although a license can create a value for the licensee, it is at the outset a right to use an intangible asset owned by the licensor, rather than the intangible itself. Notably a short term license is not an intangible asset by itself, This does not prevent the authorities and the taxpayer to include such licenses in a transfer pricing analysis in order to verify whether or not the right to use the intangible by another party is adequately compensated. We believe it is crucial to distinguished co-ownership of an intangible by related parties from appropriate compensation for the use of an intangible. For example, the grant of a distribution license does not trigger the transfer of the underlying intangible from the licensor to the licensee, nor any split in the ownership of the intangible.

- Paragraph 21 needs to be drafted in more precise terms as it affects a very significant concept (goodwill and ongoing concern). As non transferrable as such, BIAC considers that goodwill and ongoing concern are not intangibles, although we recognize that, in combination with an intangible, it has to be taken into account into the transfer pricing analysis in case of transfer of the underlying intangible, and this analysis is already appropriately handled under Chapter IX. We believe that treating goodwill as an intangible as such (where no clear definition exists and where it does not exist without being coupled to another asset) will allow tax authorities to label any
excess return/non defined value as intangibles value and will bring more uncertainty than clarification to the current guidelines. It should be very clearly stated that, as opposed to what paragraph 21 states, the expectation of future trade never qualifies as an asset, and is not an intangible asset. The reputational value may be a component of the valuation of an intangible asset, but is not an intangible in itself. This paragraph refers to the elements to take into account in order to value an intangible vs. being intangibles themselves. If a reference to the role that reputation and goodwill play is still relevant to the OECD, they may be quoted in another section to avoid confusion.

- BIAC strongly disagrees with the current drafting of Paragraph 26 of the Discussion Draft treating the transfer of a couple of employees as the transfer of intangible assets. BIAC believes it is not appropriate and will create non-manageable situations for both MNEs and revenues as well as many potential double taxation issues. We however recognize that such transfer may give raise to an appropriate compensation as any service may per Chapter IX of the Guidelines.

Section B: Identification of Parties Entitled to Intangible Related Returns (paragraphs 27-56 and examples 1-11)

General Comments

BIAC believes that the principle of entitlement should be rooted in Article 9 and should primarily refer to comparison with comparable uncontrolled arrangements. Assumptions about how parties behave should be replaced with comparisons with uncontrolled arrangements.

The definition of intangible related return is confusing and unnecessary in this section..

The apparent emphasis on physical performance of functions seems to impose non-arm’s length arrangements on related party transactions.

Main Comments

The principle adopted for determining entitlement to intangible related returns is critically important. The draft includes preliminary statements in bold:

“Working Party No. 6 delegates are uniformly of the view that transfer pricing outcomes in cases involving intangibles should reflect the functions performed, assets used, and risks assumed by the parties. This suggests that neither legal ownership, nor the bearing of costs related to intangible development, taken separately or together, entitles an entity within an MNE group to retain the benefits or returns with respect to intangibles without more.”
The first sentence seems reasonable. The second sentence makes a suggestion which is partially correct: to determine “assets used” in keeping with the first sentence, then some consideration needs to be paid to ownership; to determine “risks assumed” in keeping with the first sentence, then some consideration needs to be paid to financial risk. It seems an uncontroversial observation of arm’s length arrangements that a party which is the legal owner and which makes investment is likely to have some interest in the benefits or returns arising. The key point is whether there can be functions performed, assets used, and risks assumed by parties other than the investor and legal owner which would, in comparable arm’s length situations, give rise to a benefit or return with respect to the intangibles. It is this point that the draft should clarify, and BIAC makes suggestions below which may help to provide clear guidance.

The most significant improvement to this section would be to start the analysis by reference to a comparison with comparable uncontrolled arrangements. BIAC believes that the principle of entitlement should be rooted in Article 9 and should refer to comparison with third-party arrangements. Such an approach would be similar to that adopted in Chapter IX (some of the principles of which have been incorporated into this draft) when considering risk allocation. Chapter IX requires comparison with third-party agreements; it is only when third-party comparables are inconclusive that one is required to consider which party controls risk (see 9.18). In the current draft, the principle gives primacy to control of risks, functions, and costs, and BIAC believes that the concept can cause uncertainty. Uncertainty arises because the required level of control and decision-making is not well understood, and there is no guidance on how it can be monitored and documented. In addition, large MNEs can have transnational committees exercising control with the result that control is not easily mapped to legal entities, as OECD requires.

BIAC suggests that the principle should be:

1. Is there evidence of similar entitlement to intangible related costs and return in comparable uncontrolled transactions? If so, these comparables should be sufficient to confirm entitlement and assess the consistency of the entitlement with the arm’s length principle.

2. If no reliable comparables can be found to support the determination of entitlement, then further analysis is required to determine whether the entitlement is one that might have been expected to have been agreed between independent parties in similar circumstances. The further analysis focuses on which parties perform the relevant functions, bear costs, and control risks.

3. Has the party with contractual entitlement performed functions and managed risks related to the management development and enhancement of the intangible?
   a) If yes, respect the contract.
   b) If no,
4. Has the party with contractual entitlement borne the costs (e.g. by remunerating a contract R&D developer on a cost plus basis) relating to the development and enhancement of the intangible? (this is to avoid the confusion during our last meeting on whether “bearing the cost” refers to the party taking the cost initially (i.e.; the contract R&D provider) and the party who ultimately carries the costs (the entrepreneur).

   a) If yes, respect the contract if that party also performed control functions (as described in 9.23) in relation to the risks arising from the development and enhancement of the intangible.

   b) If no, since the party with contractual entitlement has neither performed functions, borne costs, nor performed appropriately defined control functions in relation to risk, the intangible related costs and return shall not be allocated to this party despite the contract.

Such a decision tree will deal with a situation which the drafters find challenging; this is how to deal with a party which bears costs. If the entitlement meets the comparability requirements in step 1, then that should be the primary test. If no reliable comparisons can be found, then the decision-tree moves to consider the performance of functions under steps 3 and 4. Even if the party outsources functions relating to the development and enhancement of the intangible, then they will participate in the intangible related returns if they perform the control functions set out in 9.23. If they do not satisfy this requirement, then the draft should make clear the consequences. Presumably they should be entitled to a finance-type return taking into account risk of the investment, and that cost should be taken into account in computing the remaining intangible related return.

The definition of intangible related returns does not work. If a definition is required, then it should be covered in the section focussing on valuation. As drafted the definition seems to describe the process of performing a residual profit split, and confuses the principle of identifying the party entitled to the return with measurement of that return. It is not at all easy to see how a simple licensing arrangement would fit well with this definition. In addition, the definition assumes that all profit is either intangible profit or routine profit; however, the draft elsewhere points out that there are other sources of excess profits arising from features which fall short of intangibles (see paragraph 124, for example). Is there any need for a detailed definition in this section, since all the section is attempting to do is to determine which party should receive any return to the intangible, whether that return is positive, negative, or zero.

Paragraphs 38 and 40 make presumptions about conduct of parties which seem without evidence. There is certainly no reference to how parties behave in uncontrolled situations, and this absence is curious. By requiring physical performance of functions, the draft may impose non-arm’s length arrangements on related party transactions.
The concepts in this section as drafted seem focussed on the development of technology intangibles, but apply less clearly to the creation of marketing intangibles, and do not seem to work for straightforward licensing arrangements. Section B.3 and the examples do not always support the principle, and introduce different concepts, particularly focussing on the amount of expenditure. The introduction of different criteria to establish which party enjoys a return from the intangibles is not helpful.

Section C: Transactions Involving the Use or Transfer of Intangibles (paragraphs 57-76 and examples 12-17)

General comments

The guidance in this section is broadly welcomed by BIAC and some of the examples provide helpful illustrations. As in the other sections, it would be helpful if the text could cross refer to the relevant examples as it is not always clear which points the examples are aiming to illustrate and in some cases the examples and text appear inconsistent.

Section C1 provides a helpful reminder that just because intangibles exist, it should not be assumed they are transferred along with sales of goods and services.

Section C2 discusses situations where intangibles are transferred. Paragraph 65 (which refers to paragraphs 1.52 et seq. but is worded differently to the original sections) could be taken as support for potentially disregarding the transactions actually undertaken, whereas Chapter 1 at 1.64 et seq. correctly mentions that this should be done in extreme cases only.

BIAC would prefer more examples and narrative covering licensing arrangements. We would also encourage clarification that outsourcing production, services or development is a normal business activity and typically does not involve the transfer of intangibles or the right to "intangible related returns".

There is reference to the importance of the comparability analysis and we wonder if a framework could be provided, building on the one in Chapter 3. Our comments in relation to Section B above provide a possible outline for this. We note that profit split is difficult and highly subjective to apply and in our view should not become a default method wherever intangibles are found.

Further there is an implication in some of the examples in this section and also the other sections that the "intangible related returns" might be divided around the group based largely on who performs the people functions. Third parties normally jealously guard their intangibles and take strenuous steps not allow them to leach away to their customers and suppliers. The temptation to allow everyone to claim a 'slice of the pie' for transfer pricing purposes should be avoided as it is not in line with the arm's length principle, could result in more uncertainty for business, and potentially more double taxation and more disputes between territories.
We strongly welcome the clarification earlier in the text that location factors and group synergies are not intangibles but comparability factors and we suggest this clarity could better flow through into the examples (for example specifying that these factors do not per se give rise to "intangible related returns").

Paragraphs 66 through 70 discuss the transfers of combinations of intangibles, and paragraphs 71 to 75 the transfers of intangibles in combination with other transactions. These sections are not clear about when separation or aggregation will be appropriate or required, and more guidance would be appreciated here. Again, a wide spectrum is often observed in third party behaviour. BIAC believes the starting point should continue to be the actual arrangements entered into by the parties (unless the arrangement used is never observed in the market AND is impossible to price - as envisaged in chapter 9.180). In our view this is a better approach than implying as in paragraphs 69 and 70 that taxpayers may be required to aggregate or required to segregate, when the parties have done something different.

We question whether the examples in paragraphs 73 and 74 are intended to be definitive for cases involving franchises ("may be necessary to segregate") and software maintenance (aggregation "may be necessary") or not. Either way, the use of the qualifier "so-called" in relation to business franchises looks pejorative - there are very many third party examples of franchise arrangements across a variety of industries. In some cases, the payment by the franchisee will be one aggregate amount and in other cases it will be split into components, such as royalty, service charges, etc.

The reiteration in paragraph 75 of the existing guidance that not all services should be "cost plus" and "not all intangibles transactions require complex valuations or …profit splits" is welcomed.

Comments on the Section C Examples:

Several of the examples (here and in the other sections) refer to disregarding or recharacterising the transactions actually undertaken. The same examples could be worded more neutrally by simply explaining how the OECD thinks the transaction should be priced instead of outlining a purportedly incorrect view as the taxpayer's position and saying what the tax authority should do to rectify it (e.g. example 12).

Example 13 should be removed as it appears inconsistent with the arm's length principle. If Ilcha made arrangements with a third party as a licensed distributor instead of with its subsidiary S, it would seem unlikely Ilcha would charge that third party for the implicit conveyance of goodwill, or indeed that the third party would be able to re sell such rights or "ongoing concern value". If S can't sell or exploit them itself, in BIAC's view they are not intangibles for transfer pricing purposes.

Example 14 also appears unnecessary as it is unclear what it is illustrating. Given that the distribution affiliates make the same margins before and after the setup of company S, and
we are told these margins are arm's length, one would have to assume that the advertising expenditure does not create an intangible for which supernormal returns would be expected. Hence it follows that S would not be entitled to "intangible related returns" even if it did perform the advertising or control the marketing. Furthermore, the wording in this example (e.g. "return to goodwill") is vague.

A reader might also assume from the last line of this example that (in line with the wording in the bold box in section B) the OECD believes that paying for an activity which could generate an intangible (or even ownership of the intangible) will never entitle the payer to any intangible related return. While BIAC agrees it should not be assumed that all intangible related returns necessarily flow to the entity which pays for an activity, this seems to promote the doing or control of activities (i.e. functions) over and above assets and risks in all cases, and appears to step away from the arm's length principle.

We strongly disagree with example 15, where in our view the analysis is flawed. It appears to assume that the price paid for a limited company must all be allocable to either specific tangible or specific intangible assets for transfer pricing purposes, ignoring accounting entries. It then makes the further leap that because there is a change in activity after the takeover from entrepreneur to contract R&D provider, T should be compensated, either immediately or in the future for this bundle of "intangibles".

Examples 16 and 17 are much clearer and more helpful, dealing with software/services respectively with and without the transfer of intangibles.

**SECTION D (Determining Arm’s Length Conditions in Cases Involving Intangibles)**

BIAC appreciates the fact that the current OECD Draft is the result of a significant effort to provide better guidance for complicated cases involving intangibles; however BIAC considers that additional efforts could be made to promote simplification and manageability of simpler cases involving intangibles.

In order to promote better certainty and efficient use of resources of both MNEs and Tax Authorities, BIAC would recommend a fine tuning of section D based on the following principles:

- Simpler rules for cases where sufficiently reliable comparables exist or reliable comparability adjustments can be made or the value of intangibles is low.
- Further refinement of the principles applying to complex cases.
- Better clarity on the distinction between complex cases requiring sophisticated methods and documentation, and simpler cases normally requiring less sophisticated methods and lighter documentation.
The main topics raising concerns are:

1. Guidance on the selection of method;
2. Services using intangibles;
3. Administrative burden; and
4. Example 19.

1) Selection of method:

BIAC’s main concern is that a new chapter VI could be interpreted as requiring the use of complicated and sophisticated methods in the majority of transfer pricing cases involving intangibles. BIAC strongly believes that the comparability analysis should remain the key driver to the selection of method: this appears to be also the recommended approach in section D1 of the Draft (in particular in paragraphs 87 to 89) and in paragraph 119 of section D3. However the wording of section D2 (“Selecting the most appropriate transfer pricing method in a matter involving the use or transfer of intangibles”), addressing all types of intangibles, seems to be mainly driving cases of “Section D.1.(vi) intangibles”: this may lead to the perception that traditional transaction methods are discredited even for intangibles for which sufficiently reliable comparables exist or reliable comparability adjustments can be made. BIAC suggest therefore that also section D2 include a clearer distinction between the principles generally applying to intangibles for which comparables exist (or comparability adjustments can be made) and the principles generally applying to “Section D.1.(vi) intangibles”.

The second concern about the selection of method is that, although the wording of paragraphs 128 and 129 fully reflects the existing guidance on the application of the profit split method, certain negative wording in the Draft in relation to the application of traditional transaction methods could create a pressure for a widespread use of profit split. As outlined above, BIAC considers it very important to promote simplification and efficient use of resources wherever possible: considering the intrinsic difficulties of profit split methods, BIAC suggests the inclusion in new chapter VI of a clarification similar to that included in the OECD letter of July 2010.

The third concern about the selection of method is related to the use of valuation techniques. The repeated reference to the usefulness of income based valuation techniques and the structure of example 19 could give the impression that valuation techniques are promoted as a primary method for valuing intangibles. BIAC observes that valuation techniques cannot be applied in a simple way, require the support of experienced specialists and a significant amount of reliable data. As a consequence it would be advisable to limit the use of valuation

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1 “The OECD does not intend that the revisions of the Guidelines require more extensive use of profit split methods nor does it believe that the language of the revised Guidelines appropriately can be read to impugn such a requirement. Profit split methods need not be applied to corroborate the results of other methods in every case. However, profit split approaches can be useful and can be the most appropriate transfer pricing method in some instances, following the criteria identified in paragraph 2.2 of the revised Guidelines.” Response of the Committee on Fiscal Affairs to the comments received on the September 2009 draft revised Chapters I-III of the Transfer Pricing Guidelines, 22 July 2010
techniques to particularly complex cases within “Section D.1.(vi) intangibles”. BIAC suggests to reflect this concept into the guidance about use of valuation techniques. BIAC also suggests the addition of a clear reference to the direction provided in Paragraph 2.9 of the Guidelines: “(…) other methods should however not be used in substitution for OECD-recognised methods where the latter are more appropriate to the facts and circumstances of the case. In cases where other methods are used, their selection should be supported by an explanation of why OECD-recognised methods were regarded as less appropriate or non-workable in the circumstances of the case and of the reason why the selected other method was regarded as providing a better solution.”

2) Services using intangibles

The specialisation and centralisation of activities is a vital requirement for MNEs to stay competitive; this leads to a growing number of exchanges of services within multinational groups, often embedding some form of intangibles. A systematic analysis and pricing of the intangible component as a separate element would lead to intolerable levels of workload and uncertainty and would conflict with the business reality of many services being priced, at arm’s length, on a cost plus basis.

Also in this case, BIAC considers that comparability is the key driver and observes that in today’s world there is a growing tendency to outsource non-core activities, including high-value adding ones.

Many independent suppliers of services use cost based pricing methods: this is a common practice also in high value adding services like Management Consulting and Software Customization, despite the fact that these categories of services imply both the use and the transfer/creation of intangibles. BIAC suggests a change in the wording of the OECD Draft (paragraph 107 of section D and also paragraph 75 of section C) to highlight the fact that intangibles utilised or transferred within a service activity do not always drive a premium margin above that charged in comparable services and consequently a cost-plus method is not automatically invalidated because intangibles may be involved. In some transactions, however, intangibles can lead to premium pricing being agreed between independent contractors. A comparability analysis should drive the identification of cases where independent contractors would agree on a premium price due to, for example, the exceptional value of the intangible, risks assumed, or the unique competitive position of the provider.

BIAC also recommends the addition of some guidance about simplified approaches to be allowed for minor transactions (either because small or not recurring.)

3) Administrative burden

BIAC is worried about the complexities and workload that can be generated by certain administrative and documentation requirements in the Draft, also considering the growing complexity of large multinationals’ organizations and the increasing number of small and medium MNEs having to deal with these issues.
BIAC’s first concern in this area is related to the requirement of documenting the options realistically available (paragraph 80). BIAC suggests to insert an explicit reminder of the concepts expressed in chapter IX (9.64): “The reference to the notion of options realistically available is not intended to create a requirement for taxpayers to document all possible hypothetical options realistically available. As noted at paragraph 3.81, when undertaking a comparability analysis, there is no requirement for an exhaustive search of all possible relevant sources of information. Rather, the intention is to provide an indication that, if there is a realistically available option that is clearly more attractive, it should be considered in the analysis of the conditions of the restructuring.”

The second concern is related to the requirement of performing a global analysis (paragraph 108).

BIAC observes that also between independent parties often a bilateral (rather than global) analysis is conducted; in addition it should not be assumed that all MNEs have transfer pricing global information easily available: they may actually be organized more on a bilateral basis for setting their transfer prices. In all these cases it would be very difficult and burdensome for MNEs to build a global analysis only to support transactions that may be legitimately priced on the basis of comparables and on a traditional bilateral approach. BIAC suggests a redrafting of paragraph 108 to clarify that if comparables can be used, no further analysis should be required. BIAC also suggest to clarify that also for “Section D.1.(vi) intangibles” a global analysis will be required only in cases where independent parties, in comparable situations, would seek to embark in a burdensome global analysis due to the complexities and interconnections of the business model.

The third concern is related to the requirements for the comparability analysis. BIAC appreciates the useful detailed description provided in paragraphs 90 to 100; however BIAC observes that there are often limitations to the details available to both taxpayers and tax administrations to perform the comparability analysis.

BIAC suggests adding to the draft an explicit reference to Section C of Chapter III (“Compliance Issues”) and to quote the key concepts included in that section about the extent of the burden and costs that should be borne by a taxpayer to identify possible comparables and obtain detailed information thereon:

- “It is recognised that the cost of information can be a real concern, especially for small to medium sized operations, but also for those MNEs that deal with a very large number of controlled transactions in many countries.”
- “When undertaking a comparability analysis, there is no requirement for an exhaustive search of all possible relevant sources of information. Taxpayers and tax administrations should exercise judgment to determine whether particular comparables are reliable.”
• “it may be reasonable for a taxpayer to devote relatively less effort to finding information on comparables supporting less significant or less material controlled transactions.”

• “Although the arm’s length principle applies equally to small and medium sized enterprises and transactions, pragmatic solutions may be appropriate in order to make it possible to find a reasonable response to each transfer pricing case”.

This addition could potentially be made either within paragraph 91 or at the end of the section, after paragraph 100.

4) Example 19

Example 19 may represent a useful illustration, but may also convey the misleading message that simple valuation models can be used.

BIAC fears that example 19 could potentially be perceived as an approved “modus operandi” rather than just an example. There is a serious concern that this could lead taxpayers or tax administrations to believe that an intangible can be easily priced on a “residual basis” by just estimating: projected revenues, costs and expenses; routine return rates; useful life; discount rates.

In addition, the example in its current version could actually drive an interpretation that appears to be in contrast with the statement in paragraph 108: “In matters involving the use or transfer of intangibles, caution should be exercised in adopting a transfer pricing methodology that too readily assumes that all residual profit from transactions after routine functional returns should necessarily be allocated to the party entitled to intangible related returns”.

Although paragraphs 149 to 170 thoroughly analyse several areas of concern in applying methods based on discounted cash flows, it can be anticipated that the example will represent the main reference for the readers: BIAC therefore suggests to include additional analytical and conceptual elements to make the example more in line with the complexities of real cases recognizing that the subject is very complicated and that reliable valuations can only be performed by specialized professionals and require a significant amount of reliable data.

BIAC also observes that even in the very simplified approach of example 19, some very difficult questions and issues arise, for which alternative and quite controversial options exist:

i) The alternative between a NAT (Net After Tax) versus an OM (Operating Margin) analysis.
ii) The tax rate to be used for the NAT analysis.
iii) The inappropriateness, in many cases, of adopting the simplifying assumption that all non-routine profit can be attributed to intangibles.
iv) The need to include into the analysis the taxes that Pervichnyi will pay if it sells the intangible (that would modify the range of realistic options for the group).

v) The need to include a reasonable assumption about the rate of return that a third party would require to make the investment (in table 2 the IRR of Company S appears to be equal to the cost of capital: a third party would be very unlikely to make such an investment).