

William Morris
Chair, BIAC Tax Committee
13/15, Chaussée de la Muette, 75016 Paris

Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development
2 rue André-Pascal
75775, Paris, Cedex 16

Submitted by email: TransferPricing@oecd.org

June 18, 2015

Ref: DISCUSSION DRAFT: BEPS ACTION 8: HARD-TO-VALUE INTANGIBLES.

Dear Andrew,

BIAC thanks the OECD for the opportunity to provide comments on its Discussion Draft on Action 8 (Hard-to-Value Intangibles – HTVI) of the Base Erosion and Profit Shifting (BEPS) Action Plan issued 4 June 2015 (the Discussion Draft). This is a very important subject.

As you yourself must be only too aware, the timeline for this consultation has been very short! In an effort, therefore, to further assist with clarity and to provide a fuller discussion of key points, BIAC will continue consulting with its members until the date of the public consultation. We will collect practical examples of arm's length dealings, and practical issues that are anticipated for the implementation of the proposed new guidance and, if these appear illuminating, will raise those additional comments or examples during the discussion at the public consultation.

BIAC interprets the structure developed by the OECD in the Discussion Draft as a welcome effort to provide a clear framework for taxpayers and tax authorities. However, BIAC observes that the subject is very complex and significant risk of diverging interpretations exist. We have, therefore, focused on trying to clarify the scenarios in the Discussion Draft.

We are concerned that the special measures for HTVI only be used in exceptional circumstances where arm's length pricing clearly has not worked. We suggest that the OECD recommend a proportionate approach to tax authorities in the adoption and implementation of such new rules. It will also be important to monitor how the new guidance will be implemented, and BIAC is available to support initiatives in that direction.

This letter is organized into two sections: an executive summary, followed by detailed comments sequentially following the structure of the discussion draft. Again, we thank you for the opportunity to comment, and stand ready to help further in any way that we can.

Sincerely,



Will Morris,
Chair, BIAC Tax Committee

EXECUTIVE SUMMARY

Given the short timeframe available for reviews, this executive summary is organized in the form of bullet points, which summarize the arguments developed in the detailed comments.

- A special measure within the arm's length principle (ALP) should be limited in scope to representing a rebuttable presumption, allowing taxpayers to bring any type of evidence to support the arm's length nature of the transaction that is being challenged. Special measures should, by nature, be applicable only in exceptional cases.
- Paragraph 4 of the discussion draft refers to the fact that "independent enterprises may determine to bear the risk of unpredictable subsequent developments": the concept should be further developed in order to acknowledge that in arm's length dealings it is possible to transfer risk "without recourse" and that multinational groups can routinely centralize IP without constantly revisiting the outcomes.
- Where an intangible did not have the nature of HTVI at the time of transfer, it should be recognized that ex-ante projections cannot be required.
- The timeframe within which retrospective adjustment could be possible should be strictly limited and specified in the guidance.
- Additional exemptions are recommended in relation to the following cases:
 - HTVI's priced indirectly using one sided methods based on sufficiently reliable comparables;
 - HTVI's for which a profit split method has been adopted reflecting the HTVI uncertainties within the profit split mechanism itself;
 - HTVI's which did not have the nature of HTVI at the time of transfer;
 - HTVI's for which the probability of unforeseeable and extraordinary events was very low; and
 - HTVI's whose value remains hard to value also ex-post (e.g. because they are part of a more complex product).
- The proposed guidance should only apply in case of very significant divergences between ex-ante and ex-post results.
- A special measure should apply only to prices set after its introduction.
- Global consensus on offsetting adjustments should be developed.
- Independent parties are more likely to modify pricing prospectively rather than retroactively.

DETAILED COMMENTS

Introduction

1. Within the discussion draft's introductory paragraphs it is stated that "The approach protects tax administrations against the negative effects of information asymmetry when specific conditions are met."
2. The "approach" therefore apparently introduces a "special measure" but it is not fully clear whether this special measure would overcome the arm's length principle (ALP) and how. In fact, the ALP seems to be preserved considering the (immediately) following sentence in the discussion draft, which we welcome: "These conditions ensure that price adjustments will only apply where the difference between expected and actual outcomes cannot be explained by considerations other than inappropriate pricing".

3. The fact that the ALP should be respected is also supported by the principle statement in paragraph 1, discussed below. BIAC would strongly support this interpretation and recommends that the OECD develop more clarity about how the approach should be applied; for example, if the ALP is to be respected, a logical consequence could be to consider the “approach” to represent a presumption that tax authorities can develop in certain specific cases defined by the “approach”, but such presumption should be fully rebuttable, i.e. the taxpayers should be allowed to bring any type of (reliable) evidence, either of an ex-ante or an ex-post nature, to support the arm’s length nature of the transaction that is being challenged.
4. More generally, re-valuations based on ex-post information do not appear to be frequent in dealings between independent parties, while the current wording of the discussion draft appears to be broad and open to widespread application of this special measure to many situations, rather than only in exceptional circumstances.

Paragraph 1

5. At the very beginning of paragraph 1 there is a reference to “whether the guidance on non-recognition applies” which gives the impression of supporting non-recognition instead of considering it an exceptional circumstance. BIAC would recommend keeping the simple reference to section D of Chapter I as an adequate reminder (implicitly including all aspects discussed in that section).
6. Paragraph 1 also states the principle that: “The question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in the pricing of the transaction.” BIAC fully agrees with this principle, which serves to confirm the prevalence of the ALP in the practical application of the “approach”. However, BIAC is concerned about the risk that some of the detailed guidance in the draft could be interpreted as partially departing from this principle, and this drives the BIAC comments and recommendations included above in the comments related to the introduction.

Paragraph 4

7. Paragraph 4 refers to the fact that “independent enterprises may determine to bear the risk of unpredictable subsequent developments”. BIAC considers the outcome of the example based on a royalty rate for the transfer of rights in intangibles to be appropriate. It should be noted that different results are likely to be appropriate in the case of transfer of an intangible and BIAC considers that the concept should be further developed in order to acknowledge that independent enterprises may determine to transfer risk “without recourse”, i.e. to trade-off the risks of uncertain future developments with a fair remuneration of the value created until the time of transfer of the intangible.
8. Two typical cases in which intra-group transfer of risk may occur are those where:
 - a. Certain IP developments are too risky to leave the uncertainties of their economic outcome on specific individual entities; or
 - b. A multinational Group is growing by acquisitions: in such cases there is often a strong business need to centralize IP in order to manage it efficiently (it should also be

noted that, in such cases, denying the economic consequences of risk centralization would raise issues going well beyond transfer pricing, because it would in fact imply not recognizing one of the purposes of the arm's length acquisition, whose "non-recognition" could not be enforced vis-à-vis the independent seller).

- c. Though these are typical situations, there might be various other examples in which such an intra-group transfer of risk occurs.
9. In relation to the points above, BIAC recommends to approach cases where a multinational group has adopted IP centralization policies by focusing on the arm's length nature of the policy and whether or not it is applied consistently: in these cases, focusing on individual transactions would be a likely source of double taxation and conflicts among taxing authorities. Furthermore, focus should be equally on successful as well as unsuccessful transfers.
 10. BIAC understands that there may be concerns in relation to the fact that IP could be centralized in tax havens. However, that issue appears to be addressed by other BEPS action items and BIAC encourages the OECD to recognize that a group can routinely centralize IP.

Paragraph 9

11. BIAC recommends to expand the concept of "reliable comparables", considering that literally this seems to apply only when comparables are searched in order to directly assess the price of the transfer of intangibles or right in intangibles. Nevertheless, BIAC observes that comparables are routinely used to indirectly set the price of intangibles using one-sided-methods (such as the TNMM), in particular in the case of transfer of rights in intangibles. BIAC recommends that the OECD clarify this concept in order to prevent uncertainties in situations that are very common, so that there is no ambiguity about the fact that taxpayers and tax authorities can continue to address the less complicated transfer pricing cases related to intangibles in a straightforward way and that, where the one-sided method used was both appropriate and based on sufficiently reliable comparables, there will be no scope for revisiting the transaction.
12. The second condition set in paragraph 9 relates to "lack of reliable projections of future cashflows." BIAC observes that, in addition to the case of one-sided methods based on comparables discussed above, the OECD should also address the case where profit split is used: BIAC considers that in the case of residual profit split the focus should be on whether the specific methodology has been set in a way consistent with the fact that the transaction included HTVI. In other words, if at arm's length the reasonable approach to deal with uncertainty was to decide a residual profit split based – for example, on "non-routine" contributions made by each party, this approach should be respected and there should not be a possibility that a tax authority revisit the transaction.

Paragraph 14

13. The approach described in the discussion draft will not apply where the taxpayer:
 - a. "provides full details of its ex ante projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in

calculations to determine the price (e.g. probability-weighted), and the comprehensiveness of its consideration of reasonably foreseeable events and other risks; and

- b. provides satisfactory evidence that any significant difference between the financial projections and actual outcomes is due to unforeseeable or extraordinary developments or events occurring after the determination of the price that could not have been anticipated by the associated enterprises at the time of the transaction.”

14. This seems to set a very high standard of analysis for the taxpayer and the second statement, in particular, appears unnecessarily onerous. For example, if the consensus opinion in 2014 was that oil prices would remain stable, yet in 2015 they fell dramatically, and a few far-sighted analysts did foresee a fall, the second condition could not be met by a taxpayer who took the majority view. This setting of idealistically high standards for taxpayers would be another example where related parties would have to demonstrate much higher standards than unrelated parties and is even more disturbing given that at the time the taxpayer is challenged, the tax authority will have the clear benefit of hindsight. . It should be noted that forecasting is very difficult, and many MNE businesses struggle with it, even for an established business. Assumptions are always uncertain. This is equally the case for intra-group transactions and third party transactions. The examples given in the Discussion Draft are rather extreme and the distinction between foreseen and unforeseen is very difficult to make. BIAC also suggests replacing ‘full details’ with ‘significant details’ in paragraph 14.
15. Furthermore, BIAC observes that there may also be cases where the intangible didn’t have the nature of HTVI at the time of the transaction and, therefore, did not require detailed ex-ante projections, but unforeseeable or extraordinary events led to outcomes quite different from those anticipated. In such cases, it should be recognized that ex-ante projections were not required, and the only requisite evidence should be related to the unforeseeable and extraordinary nature of the events. This point also raises the more general concern of burden of proof. BIAC would encourage guidance to be issued on this point that would prevent oversimplified challenges to translate into extremely burdensome justifications to be developed by taxpayers.

Additional points

16. BIAC appreciates the efforts made in the discussion draft to highlight points on which contributions are openly invited; we provide comments here below on each of the specific questions.

- a. Mechanisms that could provide greater certainty:

The timeframe within which retrospective adjustment could be possible should be established with reasonable certainty. A short timeframe would be strongly advisable in order to provide certainty to taxpayers and reflect the fact that in third parties dealings certainty is often a desired element. It should also be at least established that in any case adjustments could not be made for years that are statute barred; in addition the taxpayers should be allowed the possibility to use

comparable arm's length contracts to assess the cut-off timing before which a tax administration should not go with retrospective adjustment.

b. Additional exemptions to the exemption contained in paragraph 14:

BIAC recommends the introduction of additional exemptions in relation to the following cases described above:

- i. HTVI's priced indirectly using one-sided methods;
- ii. HTVI's for which a profit split method has been adopted and construed in a way that was designed to address the HTVI uncertainties within the profit split mechanism itself; and
- iii. HTVI's which did not have the nature of HTVI at the outset (or for which the probability of unforeseeable and extraordinary events was assessed as being so low that it would not be reasonable to require projections to be made for options with such negligible probability).
- iv. HTVI's whose value remains hard to value also ex-post (described below).

c. Definition of the notion of "significant difference":

In determining when an adjustment may be necessary, the proposed guidelines should recognize that in virtually every case ex-ante and ex-post returns will diverge because ex-post results reflect the realization of risk and other events rather than their anticipation. So, it is very important that the proposed guidance does not apply in the absence of significant divergences between ex-ante and ex-post results. The OECD should adopt a standard that if the ex-post results are within a range of the ex-ante projections, then no adjustment should be required under these provisions. Further, the ex-post results should be examined from a multiple-year perspective (a five-year rolling average, for example) such that individual year anomalies are smoothed out.

d. Further comments:

- i. BIAC observes that a special measure should not apply retroactively and would request the OECD to clearly establish that this special measure apply only to prices set after its introduction.
- ii. BIAC also would like to stress the point that the symmetry of price adjustments should be recognized. Adjustments may be upward or downward and affect both parties in the exchange. Any one-sided approach that does not take into consideration the symmetry of the taxation burden may lead to double taxation. It is therefore absolutely critical to ensure a global consensus on offsetting adjustments.
- iii. BIAC also observes that HTVI's may remain HTVI's also ex-post, for example in cases where the transferred intangible or rights in an intangible do not

generate a clearly identifiable income attributable to the intangible, in particular in cases in which the intangible is part of a more complex product or service. In these cases it should be made very clear that the “approach” cannot be utilized to arbitrarily attribute a value to an intangible on an ex-post basis if such intangible remains hard to value: in such cases the standard transfer pricing guidelines should simply apply.

- iv. Finally, in the case of transfer of rights in intangibles, it should also be acknowledged that the parties will first monitor results that are significantly different from what was anticipated in order to assess whether the change is permanent or temporary. In addition, independent parties are much more likely to modify pricing prospectively rather than retroactively.