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IMPLEMENTATION GUIDANCE ON HARD-TO-VALUE INTANGIBLES

Dear Mr. VanderWolk,

Business at OECD (BIAC) thanks the OECD for the opportunity to provide comments on its Discussion Draft on Implementation Guidance on Hard-to-Value Intangibles ("HTVI") issued 23 May 2017 (the "Discussion Draft").

This is a very complex subject and there is a significant risk of diverging interpretations. Therefore, BIAC welcomes the aim of the Discussion Draft to provide a common understanding for tax administrations with respect to adjustments resulting from the HTVI approach. However, we are concerned that the guidance is rather broad, but the examples not comprehensive enough. This means that it may be difficult for taxpayers to determine how they should approach a valuation exercise to ensure that they are deemed to have priced the transaction appropriately (i.e. to perform a valuation that protects them against adjustments in later periods). We offer some suggestions on how that certainty might be increased in ways that we believe will benefit both taxpayers and tax authorities.

Again, we thank you for the opportunity to comment, and stand ready to help further in any way that we can.

Sincerely,

Will Morris

Will Morris, Chair
BIAC Tax Committee

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GENERAL COMMENTS

1. HTVI is a highly complex subject, largely due to the subjectivity involved in trying to look into the future at the time of the transfer, allied with the difficulty of ignoring what actually happened after the transfer when judging the reasonableness of the original pricing decisions. Therefore, guidance intended to establish a common understanding amongst tax administrations and provide for consistent application of the HTVI approach must be sufficiently detailed to give both taxpayers and tax authorities confidence that adjustments are based on the pricing not having been made at arm's length at the time of the transfer, rather than as a result of hindsight (which our members fear would only lead to an adjustment where the adjustment favoured the tax authority).

2. The Discussion Draft primarily reiterates the broad concepts that were provided as part of the 2015 Final Report for Actions 8-10, "Aligning Transfer Pricing Outcomes with Value Creation" ("BEPS TP Report"). BIAC acknowledges that this may be an area where a number of tax administrations have limited experience, particularly in developing countries, but this fact should highlight the need for practical and unambiguous guidance over broad generalisations that may result in further uncertainty.

3. There is currently a very broad definition as to what constitutes a HTVI. While we appreciate that it would be nearly impossible to define precisely, we thought that additional helpful clarity may come from providing a list of features that indicate what is <u>not</u> considered a HTVI. There will be instances where an intangible clearly falls within the scope of the HTVI approach but often times it may be the case that intangibles are not isolated and perhaps merely contribute to one single piece of technology. It is unclear under the current definition whether the HTVI approach would be applicable in such instances.

4. BIAC acknowledges that the practical application of the exemptions listed in paragraph 6.193 of the BEPS TP Report, including the measurement of materiality and time periods contained in the current exemptions, will be reviewed by 2020 in light of further experience. This review will be welcome but we would urge the OECD to provide additional guidance in the interim related to these exemptions. This is a subject that will significantly affect many taxpayers in the immediate future so detailed guidance on the application of exemptions would be extremely useful.

5. The examples provided in the Discussion Draft are slightly limited and as a result do not provide as much clarity as they might into this complex subject. We recommend that the examples be expanded to provide tax administrations and taxpayers with factors that should be considered when drawing the critical line between whether there was or was not an appropriate weighting of the foreseeable developments or events relevant for the valuation at the time of the transaction.

6. Additionally, we believe the examples should not be limited to an analysis of HTVI solely within the pharmaceutical industry. This may have the unintended effect of drawing a line in the eyes of tax administrations that HTVI only exist in the pharmaceutical industry and may not reflect the more gradual development of intangibles in other industries.

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7. BIAC would recommend including additional examples that cover multiple industries and results, including instances where no adjustment would be required (not due to the application of a specific exemption) and where multiple factors are considered and addressed to be within or without the scope of "anticipated" events. For instance, we would strongly support including an example which stresses the fundamental concept that ex-post evidence is to be used as a presumptive element to recalculate the ex-ante pricing and not as a straightforward element to make adjustments based on hindsight.

8. BIAC believes that guidance related to HTVI should also include insight into the relationship with other OECD transfer pricing guidance, specifically, profit splits of anticipated profits. For example, the recently released 2017 Discussion Draft on *Revised Guidance on Profit Splits* provides that the transactional profit split method may be the appropriate method where one party to the transaction does not share in the assumption of the economically significant risks which may result after entering into the transaction, and therefore a split of anticipated profits would be more appropriate. In such instances, guidance on HTVI should be very clear that ex-post results may (exceptionally) represent an indicator that anticipated profits were miscalculated, but this should not equate to ex-post results being used in a manner that by default will result in the application of the transactional profit split method based on actual profits versus anticipated profits.

DETAILED COMMENTS

Chapter 1: Introduction

Paragraph 5: BIAC agrees that information asymmetry between the information available to the taxpayer and the absence of information available to a tax administration is an area of concern to many tax authorities. However, BIAC would encourage additional guidance to incorporate an element of "proportionality" into any efforts to tackle this issue. It will be very important to avoid arriving at default presumptions that may have a disproportionate effect on smaller multinational enterprises ("MNEs"), MNEs whose product involves a very limited component of intangibles, or MNEs whose intangibles are marginal in relation to their overall business (i.e., intangibles that result incidentally but are not related to the core business of the MNE). This issue should also be addressed by the introduction of materiality thresholds such that the proportionality of efforts could be tied to the size of a specific transaction.

Paragraph 7: The OECD is correct in recognizing that the nature of the approach to HTVI will inevitably require consideration of timing issues and BIAC supports the application of audit practices by tax administrations in this regard. The Discussion Draft notes that tax administrations may face difficulty in evaluating the reliability of supporting information at the time of the transaction or shortly thereafter, but the reference to such analysis only being possible "some years after the transaction" must be balanced with the need for certainty on the part of taxpayers.

Whilst we appreciate that some intangibles may not realise their value for many years, this does not always result in a favourable result for taxpayers (and in fact increases the uncertainty of the valuation). BIAC strongly supports a recommendation for countries to incorporate statutes of limitation that will allow tax administrations reasonable time to collect the appropriate information on which to base a potential pricing adjustment and provide taxpayers with a sufficient amount of certainty. There must be a point in time where adjustments can no longer be made (particularly

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where a tax authority has had an opportunity to examine and assess the underlying documentation and assumptions) and that should be clear to all stakeholders.

Paragraph 12: The Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("Transfer Pricing Guidelines") provide in paragraph 6.192 that *"(…) In evaluating the ex ante pricing arrangements, the tax administration is entitled to use the ex post evidence about financial outcomes to inform the determination of the arm's length pricing arrangements, including any contingent pricing arrangements, that would have been made between independent enterprises at the time of the transaction, considering the guidance in paragraph 6.185."*

Paragraph 6.185 states that "*(…) If independent enterprises in comparable circumstances would have agreed on the inclusion of a mechanism to address high uncertainty in valuing the intangible (e.g. a price adjustment clause), the tax administration should be permitted to determine the pricing of a transaction involving an intangible or rights in an intangible on the basis of such mechanism. (…)".*

BIAC believes that this guidance addresses the requirement to assess what conditions would have been established ex-ante at arm's length to justify application of a different mechanism. However, it appears the language included in the Discussion Draft, which references paragraph 6.192 of the Transfer Pricing Guidelines creates a significant risk that the guidance in the Discussion Draft will be interpreted as providing tax authorities with the ability to choose a different pricing *mechanism* ex-post without reference to what unrelated parties would have done at the time of the transaction. BIAC would recommend that this language – as well as similar language contained in Paragraphs 13 and 28 of the Discussion Draft – be clarified to avoid tax administrations arriving at this incorrect interpretation.

Chapter 2.1: Example 1 – Scenario B

Paragraph 23: An exemption provided by item (iii) in paragraph 6.193 of the BEPS TP Report results in no adjustment being made by the tax administration in Scenario B of Example 1. There is an additional note that an adjustment under other sections of the Transfer Pricing Guidelines may be appropriate notwithstanding that the HTVI approach does not apply. BIAC believes that this sentence could be misinterpreted by tax authorities as a direction to seek other reasons on which to make an assessment. We would expect tax administrations to consider all appropriate adjustments so raising this point explicitly seems to go beyond the "neutrality" of spirit that an arm's length approach would require.

Chapter 3: HTVI and the Mutual Agreement Procedure

Paragraph 32: BIAC welcomes the access to the mutual agreement procedure ("MAP") for cases of double taxation arising from the application of the approach for HTVI. We would recommend additional guidance be provided as to how the approach for HTVI will fit within the MAP framework and specifically, the application of the presumptive evidence approach.

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