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

By email to: TransferPricing@oecd.org

18 June 2015

Dear Mr Hickman,

Comments on the Public Discussion Draft on Arm's Length Pricing of Intangibles when Valuation is Highly Uncertain at the Time of the Transaction and Special Considerations for Hard-to-Value Intangibles

Thank you for the opportunity to provide comments on the Public Discussion Draft on *BEPS Action 8: Hard-to-value intangibles* (the "Discussion Draft") dated June 4, 2015.

PricewaterhouseCoopers LLP ("PwC"), on behalf of its international network of Member Firms, welcomes the consideration given by the OECD to develop an approach to hard-to-value intangibles and the proposed revisions to the existing guidance of Chapter VI of the OECD Transfer Pricing Guidelines.

As a global professional services business with a network of firms throughout the world, we have worked with tax authorities globally over many years regarding the development of transfer pricing rules that affect multinational entities ("MNEs") in their cross-border transactions. As a result, we have extensive experience with a wide range of issues relevant to both taxpayers and tax authorities.

In our previous submissions to the OECD in connection with BEPS Actions 8, 9 and 10, we expressed that any special measure considered by the OECD should be consistent with the arm's length principle. Today, differing guidance exists providing direction on how transactions should be considered within the sanctity of the arm's length principle. Any additional special measure that goes beyond the arm's length principle is likely to lead to significant uncertainty and unpredictability. In that respect, we are pleased to see that the OECD has removed from the Discussion Draft some of the initial proposals it envisaged for dealing with "thick capitalisation", "minimal functional entity" and "capital-rich asset owning companies".

Although the Discussion Draft attempts to set boundaries around situations where it may be appropriate for tax administrations to use *ex post* information, we believe that the Discussion Draft depends too heavily on subjective terminology to set those boundaries. In particular, the language used around the provision of "satisfactory evidence", "significant differences" between expectations and outcomes and whether outcomes were "unforeseeable", "extraordinary" or could have been "anticipated" paves the way for tax authorities to claim the right to use *ex post* information in almost

any situation dealing with intangibles that fall into the overly broad defined category of "hard-to-value" intangibles.

In the following, we set forth an overview of some concerns we wish the OECD to address so as to preserve some fundamental tenets of transfer pricing and the arm's length principle.

Detailed Comments:

1. There are many reasons why OECD member countries and other countries have adopted the arm's length principle. One of the major reasons is that the arm's length principle provides broad tax parity of tax treatment for members of MNE groups and independent enterprises. Because the arm's length principle puts associated and independent enterprises on a more equal footing for tax purposes, it avoids the creation of tax advantages or disadvantages that would otherwise distort the relative competitive positons of either entity. By removing tax considerations from economic decisions, the arm's length principle promotes the growth of international trade and investment.

   We are concerned that the Discussion Draft – and paragraph 5 in particular – deviates significantly from the arm's length standard as it may support the ability of tax authorities to re-characterise almost any transfer of intangibles based on pure speculation about alternative, hypothetical pricing arrangements that could possibly have been entered into by independent enterprises. By suggesting that tax administrations should be permitted to determine pricing on the basis of the fact that independent enterprises would have insisted on a price adjustment clause or would have considered subsequent fundamental developments, paragraph 5 – if accepted in final form – is likely to lead to significant uncertainty and unpredictability regarding the pricing of intangibles. PwC finds it particularly concerning that the OECD does not sufficiently consider that MNE groups, as would independent enterprises, have specific business insights, expertise, know-how and information all of which are important elements when determining the arm's length price at the time of a transaction. Conversely the OECD seems to have overlooked the fact that tax authorities might lack such know-how, information or expertise. The proposed measure seems to be purely designed to enable tax authorities to re-characterise the transaction based on a mere *ex post* assessment – even in the continuous absence of specific business insights, expertise and know-how – as to whether potential future developments where appropriately weighted by the taxpayer at the time of the transaction. This is further amplified by the examples given by the OECD in paragraph 15 of the Discussion Draft – *i.e.* the unexpected bankruptcy of a competitor or a natural disaster - which seem to be setting an inappropriate benchmark of what would constitute "unforeseeable" events at the time of the transaction.

   PwC recommends that the proposed revisions to the OECD Guidelines focus on providing objective advice to MNEs rather than installing an overly broad re-characterisation measure. The current Discussion Draft includes too many subjective terms that may be pejorative and, therefore, interpreted differently by rational decision makers. More time and consideration needs to be devoted to refining the Discussion Draft as the measure proposed could fundamentally change the existing transfer pricing rules implemented by many countries and is likely to lead to increased double taxation globally. In that respect, PwC is of the opinion that such additional consideration needs to be provided to the entirety of the measures proposed in the Discussion Draft and not only to the "additional points" on which the OECD requested to receive input. Moreover, in doing so, PwC recommends the OECD to give appropriate consideration to the time limits within which tax administrations would be allowed to invoke the application of the special measure. The more time that has elapsed between the time of the transaction and the auditing thereof by tax administrations, the more likely it is that the burden of proof imposed on taxpayers to

pwc

demonstrate that they should have considered subsequent developments will become disproportionate to the powers allotted to tax administrations and the precious balance sought by the OECD between the use of *ex post* information and hindsight is distorted.

2. Whilst the Discussion Draft notes that the proposals made should be distinguished from the situation in which hindsight is used inappropriately by not taking into consideration whether information could or should have been reasonably known and considered by the associated enterprises at the time of the transfer, PwC is of the opinion that the Discussion Draft fails to consider the conduct of the parties subsequent to the transfer of the intangible. Whereas differences between *ex ante* and *ex post* profit levels might be related to developments or events arising after the transaction, PwC recommends that the OECD amend the Discussion Draft so as to ensure that tax authorities equally recognize the role of parties in developing, enhancing, maintaining, protecting and exploiting the intangible when assessing the differences in *ex ante* and *ex post* profit levels and whether the differences can be tied to the functions performed, risks assumed and assets deployed by the parties to the transaction. Consideration of the foregoing would better fit within the full scope of proposals made by the OECD in relation to its work on the transfer pricing aspects of intangibles as part of Action Plan item 8.

3. PwC believes that the combination of the wording proposed by the OECD in paragraphs 9 and 10 does not sufficiently limit the power of tax authorities to invoke the possibility to use *ex post* information. PwC believes that paragraph 9 already concludes on the fact that for any of the intangibles falling in the "hard-to-value" intangibles definition, (i) no sufficiently reliable comparables exist; (ii) there is a lack of reliable future cashflows; or (iii) income expected to be derived from the transferred intangible or the assumptions used in valuing the intangible are highly uncertain. Moreover, PwC is of the opinion that the definition of hard-to-value intangibles as proposed by the Discussion Draft is overly broad and, hence, almost any category of intangibles could be seen by tax authorities as falling within this definition. Therefore, the current Discussion Draft does not seem to impose an obligation on tax authorities to attempt to reach a conclusion consistent with the arm's length principle that is satisfactory to all parties involved taking into account the facts and circumstances of the case and the mix of evidence available as proposed by paragraph 2.11 of the OECD Guidelines.

4. The wording of paragraph 9 of the Discussion Draft seems to indicate tax administrations may or may not choose to adopt the measure proposed by the Discussion Draft. Hence, if the Discussion Draft would be finalised in its current form, MNEs are likely to be confronted with situations whereby a tax administration of one of the relevant countries to a transaction has adopted the measure proposed by the Discussion Draft whereas the tax administration of the other country has not. In order to avoid instances of double taxation - which might arise as a result of a tax administration of the country that has not adopted the measure proposed by the Discussion Draft claiming that the adopted measure is inconsistent with the arm's length principle as a result of which the case would not eligible for resolution under the Mutual Agreement Procedure – we recommend the OECD to (1) give further consideration to the measure to make sure it meets the arm's length standard and (2) suggest agreement by tax administrations (even if they did not adopt the proposed measure themselves) to consider the approach adopted by a tax administration of another country so as to guarantee eligibility for MAP to resolve double taxation. This could for instance be included in the scope of the OECD's work on Action Plan item 14.

5. Although PwC applauds the Discussion Draft's attempt to set boundaries around the situations where it would or would not be appropriate for tax administrations to use *ex post* information, PwC is of the opinion that the boundaries proposed in the Discussion Draft depend upon

subjective terminology such as "providing satisfactory evidence" about "significant differences" between expectations and outcomes and whether outcomes where "unforeseeable, extraordinary or could have been anticipated". In this respect, PwC recommends the OECD consider introducing more tangible exceptions to the use of *ex post* information by tax administrations. Such exceptions could take the form of a safe harbour deviation between the *ex ante* and *ex post* results (e.g. in case the *ex post* results are within an 80% - 120% bandwidth of *ex ante* results) or a time limit to the period in which tax administrations can use *ex post* information (e.g. in case *ex post* results of the first 3 or 5 years following the transaction fall within an acceptable bandwidth of *ex ante* results, tax administrations should not be allowed to use *ex post* information beyond that 3 or 5 year period).

PwC is of the opinion that the Discussion Draft in its current form provides too much leeway to tax authorities to claim that the evidence provided by a taxpayer is not satisfactory and, hence, if the Discussion Draft would be finalised in its current form it is very likely that tax authorities will claim the right to use *ex post* information in almost any situation where reliable comparables are not available to support the pricing of an intangible that ultimately turns out to be successful in the marketplace. In conclusion, with regard to the special measure proposed for hard-to-value intangibles, PwC believes that the currently proposed measure seems to be underdeveloped at this stage. We would, therefore, recommend that the final measure be developed so that it can provide objective guidance to MNEs and tax administrations, and ensure that it remains consistent with the arm's length principle and also with the OECD's remaining output on the relevant items under BEPS Actions 8, 9 and 10. Importantly, care must be taken so the final Guidelines do not, in effect, pave the way for tax authorities to claim the right to use *ex post* information in almost any situation dealing with intangibles that fall into the overly broad defined category of "hard-to-value" intangibles.

***

On behalf of the global network of PwC Member Firms, with the contribution of our colleagues David Ernick, Patrick Boone and Jonas Van de Gucht, we respectfully submit our response to the Public Discussion Draft on BEPS Action 8: Hard-to-Value intangibles. For any clarification of this response, please contact the undersigned or any of the contacts below.

Yours faithfully,

Isabel Verlinden
Partner
PricewaterhouseCoopers, Brussels

Adam M. Katz
Partner
PricewaterhouseCoopers LLP, New York

cc Stef van Weeghel, Global Tax Policy Leader

PwC Contact	Email
Adam M. Katz	adam.katz@us.pwc.com
Isabel Verlinden	isabel.verlinden@be.pwc.com
David Ernick	david.ernick@us.pwc.com
Patrick Boone	patrick.boone@be.pwc.com
Jonas Van de Gucht	jonas.van.de.gucht@be.pwc.com