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VIA E-MAIL (TransferPricing@oecd.org)

BEPS Action 8: Discussion draft on Hard-to-value Intangibles

**Comments by Pim Fris, Emmanuel Llinares and Guillaume Madelpuech,
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Dear Mr. Hickman,

In the context of the BEPS Action Plan, OECD has released on June 4, 2015, a discussion draft of proposed revisions to Section D.3 of Chapter VI of the Transfer Pricing Guidelines (the “Draft”), intended to give guidance relating to hard-to-value intangibles (“HTVI”s). We wish to thank you for the opportunity to provide comments on this document and offer you the following observations.

The Draft emphasizes difficulties experienced by tax administrations “as a result of information asymmetry” as the reason for developing an approach that should protect tax administrations against the negative effects thereof. It is striking that this perception of tax administrations (which is by no means limited to HTVIs) seems to find its match in the degree of urgency of the difficulties, repeated manifold, perceived by business as a result of insufficient guidance and multiplication of administrative burden in matters of transfer pricing. We think that both categories

¹ These comments represent independent views of the authors and do not necessarily reflect the views of NERA Economic Consulting

of perceptions, as realistic as they may seem, are insufficient as justification for exceptional measures. We are intimately convinced that solutions to the HTVI issues raised in the Draft can be and should be developed within the framework of the arm's length principle, and do not call for special privileges for tax administrations.

The arm's length principle ultimately requires the identification of behaviour of independent parties, whether found in practice or as a result of bargaining analysis, in commercial and financial relations similar to the ones between related parties concerned. That can only be based on careful and comprehensive analysis of the circumstances at hand, as well as on appropriate communication thereof between a business and the tax administrations concerned. This is the case for flows of transactions as well as for incidental transactions and, in our opinion, HTVIs are no exception to this rule.

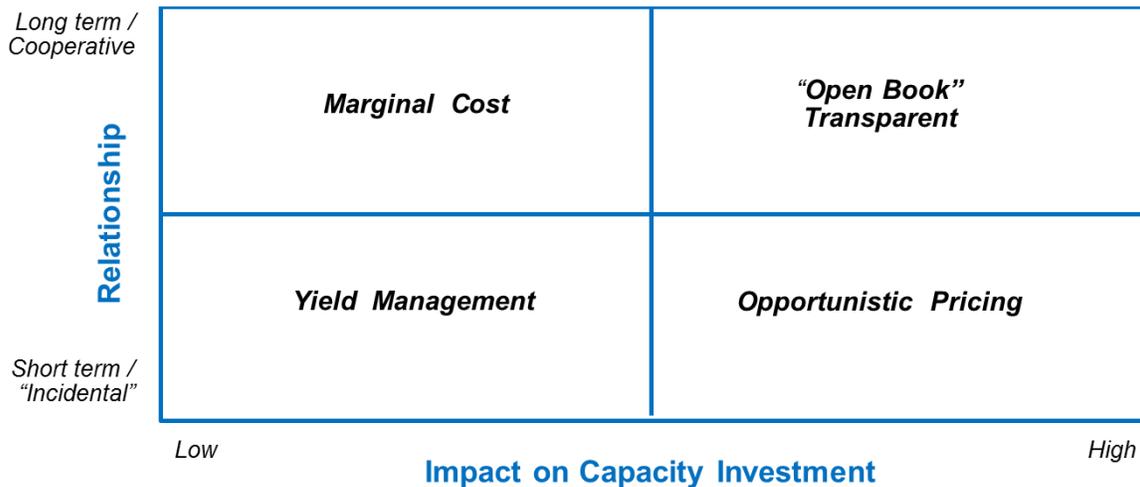
1. “Foreseeability, uncertainty and unpredictability”

Dealing with uncertainty and, to an extent, unpredictability are the key challenges for business undertakings. In our previous comments to the discussion draft of 19 December 2014 on revisions to Chapter I (including Risk, Recharacterisation and Special Measures), we applauded the introduction of relations between associated parties as the explicit analytical starting point for the application of the arm's length principle in order to accurately delineate the actual transactions in a transfer pricing context.

This starting point is highly relevant for the HTVIs, as the way in which consequences of uncertainty (i.e., risks) are attributed between parties to a transaction can vary considerably, for a same transaction, depending on the relationship between the transacting parties. Parties to an incidental transaction that have no further business relationship will have very different approaches to pricing of the transaction (even if it concerns a HTVI) than when they remain in a cooperative relationship, although in different qualities than before.

The Draft would, to our opinion, improve its guidance by moving from uncertainty and unpredictability as its focus (as that is inherent to any business enterprise) to the relational context in which the transaction between (related) parties concerned takes place ².

In this respect we respectfully refer to our comments to the Discussion Draft of 19 December 2014 in respect of the Market Pricing Matrix. For ease of reference, we have copied below the Market Pricing Matrix as presented in our comments.



This matrix illustrates the relationship between the nature of the investments required as part of a relationship (low or high) and the time horizon of the relationship (short term or long term). The actual pricing of the transaction is dependent upon these two parameters. We believe that reflecting the importance of the analysis of relationships in Chapters 1, 2, 3 and 6 of the Guidelines would go a long way in answering point 1 raised in the discussion draft on the mechanisms that could be adopted to provide greater certainty for taxpayers.

² The Market Pricing Matrix concept and the underlying principles are discussed in further details in “*The State of the Art in Comparability for Transfer Pricing*”, Pim Fris and Sébastien Gonnet, International Transfer Pricing Journal, March/April 2010.

In terms of the Market Pricing Matrix, the relevant fields are the ones on the right hand (as we would expect HTVI transactions to have a significant impact in terms of capacity investment). Depending on the relationship after the transaction, pricing will vary from opportunistic to open-book. Within the last variant, issues representative in a context of continued cooperative relationships are contingent pricing, use of real options and ultimately renegotiations. These elements should find a place within pricing based on the arm's length principle.

2. “Ex-ante” and “ex post”

The Draft suggests that due to information asymmetry between tax payer and tax administration in respect of HTVI transactions, tax administrations should be granted the right to consider ex post evidence about actual financial outcomes of the transfer. We kindly draw your attention to the fact that the distinction between ex ante pricing (price setting) and ex post judgment thereof (price testing) is not unique to HTVI transactions. It is a categorical issue in transfer pricing, as price setting is always based on projections regarding the development of relevant parameters in the future. It is obvious that degree of uncertainty increases as the horizon for projections is further away, but that is the same for tax payers and tax administrations alike. Again, the critical question is how transacting parties share consequences of this increased uncertainty. That is directly linked to the relationship between parties following the HTVI transaction. Hence, we believe that, as suggested in the current Discussion Draft, in the context of high uncertainty, the structuring of the transaction itself would be impacted. For example, we believe that corresponding transactions may include specific features such as contingency payments. The question for the taxpayer would be to explain why contingent payments were or were not needed and for the tax authorities to assess the validity of these arguments.

Notwithstanding the above, we welcome the text in paragraph 14 which could help if indeed special measures are needed. In this respect, we would then suggest replacing the term “comprehensiveness” in 1. by “appropriateness”. Also, in our opinion, the actual difference mentioned in paragraph 13 would be highly dependent upon the intangible being valued and the

circumstances of the transaction. In this context, we believe that attempting to qualify the term difference as mentioned in point 2 is unrealistic.

In conclusion we stress the need for a stronger focus on the commercial and financial relationship between parties involved as it existed prior to, and will exist after, the HTVI transaction. Within continued long term cooperative relations, parties will find ways to share consequences one way or the other. Rather than suggesting a special measure, the Draft should emphasize the carrying role of economic analysis in the development of arm's length arrangements for HTVI transactions.

Sincerely yours

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