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17 June 2015


Andrew Hickman
Head, Transfer Pricing Unit
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**Via Email: transferpricing@oecd.org**


**RE: Public Discussion Draft on BEPS Action 8: Hard-to-Value Intangibles**

Dear Mr. Hickman:

On 19 July 2013, the OECD published an *Action Plan on Base Erosion and Profit Shifting* (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries' tax bases are being eroded or profits shifted improperly. Pursuant to Action 8 of the Plan, on 4 June 2015 the OECD issued a public discussion draft entitled *BEPS Action 8: Hard-to-Value Intangibles* (hereinafter the Discussion Draft or Draft).

The OECD solicited comments from interested parties no later than 18 June 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD's request for comments.

**TEI Background**

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws,

at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.[1]

**TEI Comments**

General Comments

TEI commends the OECD for its work on hard-to-value intangibles as reflected in the short and succinct Discussion Draft. The abridged nature of the Draft makes it possible for stakeholders to provide input within the 14 day deadline provided, although that period is far too short for such an important issue. Regrettably, even in such a short Discussion Draft it seems the OECD still cannot produce a consensus view on this critical topic. If a consensus approach is not developed for hard-to-value intangibles by the end of the BEPS project, then tax authorities will likely adopt different views and methods, leading to controversy and double taxation. TEI urges the OECD and the states participating in the BEPS project to find a reasonable and consistent approach to the issues surrounding hard-to-value intangibles and avoid the negative outcomes that will result if varying methods are adopted across jurisdictions.

Specific Comments

Paragraph 4 of the Discussion Draft seems to indicate that independent enterprises are able to re-negotiate agreements if major unforeseen developments occur. In TEI's experience, however, such re-negotiations are extremely rare, and even a "re-pricing" or some sort of after-the-fact review of contract terms are not common in contracts between unrelated parties. It is true that, as noted in paragraph 3, agreements may be structured to minimise the business risk of a "bad deal," such as a shorter contract term, or through the use of a price adjustment or contingent payment mechanism based upon meeting certain milestones. Needless to say, in contracts between unrelated parties these terms are set at the outset of the contract through negotiations using only *ex ante* information. And we again note that it is rare for a contract to provide for a full re-negotiation or re-pricing if unforeseen circumstances arise. The possibility of unforeseen events and circumstances is typically part of the business risk that each enterprise assumes, for better or worse. Moreover, milestone or price adjustments between unrelated parties typically only span a short period, generally no more than three years even if the full contract term is longer. This should be noted in the Discussion Draft, which currently reads as if such price adjustments are open ended and thus seemingly allows for the use of *ex post* results and information at any time during the contract term to retroactively adjust pricing.

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[1] TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

The key limiting factor in the Draft's discussion about the renegotiation of contracts between unrelated parties is that a renegotiation may occur if it is to the parties' "mutual benefit."[2] In TEI's view, this is a critical qualification that must be satisfied (among other things) before tax authorities are permitted to adjust the terms of a contract between related parties. Tax authorities should not be able to modify contract terms or pricing merely because one of the parties obtained a significantly better deal than expected. Any such renegotiation must also be to the advantaged party's benefit, as would be the case in a renegotiation between unrelated parties in circumstances where one side received unanticipated benefits.

Nevertheless, the Discussion Draft essentially condones the use of hindsight by allowing tax authorities to use *ex post* evidence and presume that an intangible is mispriced if there is a significant difference between the *ex post* "correct" price (the "actual financial outcomes" in the Draft's phrasing)[3] and the *ex ante* price unless the taxpayer meets the criteria listed in paragraph 14. This approach would be a significant departure from long established transfer pricing principles. It is extremely difficult for multi-national enterprises (MNEs) to perform financial forecasts of new products and services, although the Draft seems to assume that MNEs can easily produce accurate forecasts and then use that ability to engage in base erosion and profit shifting related to intangible assets. The Discussion Draft, by requiring probability-weighted risks and comprehensive consideration of reasonably foreseeable events and other risks, would place an unreasonable administrative burden and cost on the taxpayer as such information is often not available and, indeed, may often go beyond the information considered when making the relevant business decision. This requirement will merely increase disputes and result in uncertainty for taxpayers. The *ex post* approach in the Draft is also one-sided, only permitting tax authorities to use subsequent information to adjust transfer prices. If this approach is to be accepted by the OECD, then it should also condone taxpayers using *ex post* information when pricing turns out to be significantly unfavorable to the taxpayer under similar circumstances.

TEI appreciates the OECD's solicitation of comments as to how taxpayers can be permitted to show that their *ex ante* pricing was appropriate via methods other than the one listed in paragraph 14. These methods should include where the taxpayer has an advanced pricing agreement with the relevant tax authority. Another permitted method should be where the taxpayer has contemporaneous transfer pricing documentation that has been completed with due care and consideration and the methodology used has previously been accepted by the tax authority. A taxpayer should be able to provide evidence that unrelated parties would not have included a price adjustment or other renegotiation clause in the contract in similar *ex ante* circumstances, even if the *ex post* results differ extraordinarily from *ex ante* expectations. Relatedly, TEI recommends that the phrase "provides full details of its ex ante projections" in section 1 of paragraph 14 be amended to read "provides significant details of its ex ante

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[2] Discussion Draft, p.3.

[3] *Id*. at 5.

projections" to decrease the compliance burden on taxpayers and to avoid inundating tax authorities with minor and insignificant details.

A mechanism that could be used by tax authorities to evaluate the thoroughness of the *ex ante* pricing and projections is evidence of internal discussions and/or sign-offs. In third-party negotiations of hard-to-value intangibles the parties will often challenge the projections used by the other party before finalising the deal, and there will be discussions on the various assumptions that underlie the projections. After that discussion, however, the deal is "closed" and not subject to renegotiation regardless of subsequent "significant differences" that might develop in the financial results.

Paragraph 13 states that permitting tax authorities to adjust the prices of hard-to-value intangibles should be "applied only in situations where the difference between *ex post* outcomes and *ex ante* outcomes is significant . . . ." The Draft then asks for comments on whether "significant difference" should be defined and, if so, how. TEI believes that such a critical term should be defined to avoid unprincipled assertions by tax authorities that almost any difference between *ex ante* and *ex post* results is significant. Thus, the OECD should further state in final recommendations that this method is to be applied rarely, and also include a requirement that the difference in results must be both greater than a certain percentage of the *ex ante* price and above a dollar threshold. A requirement that the dollar threshold be material to the taxpayer would also be welcome.

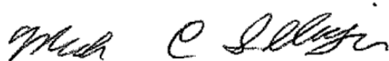
As a way to provide greater certainty to taxpayers in this area, the OECD could recognise the use of imperfect comparables for the purpose of determining whether a price adjustment mechanism would be included in a contract between unrelated parties. For example, if an MNE has purchased a tradename from an unrelated party and no price adjustment clause was included, the OECD could recognise that this as evidence that no price adjustment clause would be appropriate where a tradename has been purchased from a related party. In other words, while the value of the unrelated-party purchased tradename may not be an accurate comparable value for a different related-party purchased tradename, the lack of a price adjustment clause in the third-party tradename purchase may be used as evidence that no price adjustment clause would be provided for in the related-party purchased tradename.

Finally, the OECD should state in its final guidance on hard-to-value intangibles that any changes to current approach to valuing intangibles only should be applied by tax authorities prospectively. That is, only to transaction occurring after the final guidance is adopted by a particular jurisdiction. A retroactive application of the guidance in the Discussion Draft would upset taxpayers' justified reliance on the rules in place when previously valuing intangibles.

**Conclusion**

TEI appreciates the opportunity to comment on the OECD Discussion Draft regarding hard-to-value intangibles under BEPS Action 8. These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of TEI's legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
**TAX EXECUTIVES INSTITUTE, INC.**



Mark C. Silbiger
*International President*