



# TAX EXECUTIVES INSTITUTE, INC.

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## RE: Implementation Guidance on Hard-to-Value Intangibles

Dear Mr. Vanderwolk:

The Organisation for Economic Co-Operation and Development (OECD) published final reports pursuant to its base erosion and profit shifting (BEPS) project in October 2015. The reports were the culmination of the OECD's *Action Plan on Base Erosion and Profit Shifting* (hereinafter the Plan), which it published in 2013. The Plan set forth 15 actions the OECD would undertake to address a series of issues that contribute to the perception of tax bases being eroded or profits being improperly shifted.

Included in the October 2015 final reports was the report under Actions 8-10 of the Plan, entitled *Aligning Transfer Pricing Outcomes with Value Creation*. The OECD subsequently released a discussion draft pursuant to Action 8 on 23 May 2017, regarding *Implementation Guidance on Hard-to-Value Intangibles* (the Discussion Draft or Draft) and requested comments from stakeholders. I am pleased to respond to the OECD's request for comments on behalf of Tax Executives Institute, Inc. (TEI).

### TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization 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 2,800 of the leading companies in the world.<sup>1</sup>

## TEI Comments

### General Comments

TEI commends the OECD for the implementation guidance on hard-to-value intangibles (HTVI) provided in the Discussion Draft. As the OECD is well aware, transfer pricing issues surrounding HTVIs present a myriad of problems for taxpayers and tax administrators alike. In particular, TEI commends the OECD for its statements in paragraphs 31 and 32 of the Discussion Draft on the importance of resolving the double taxation of income through the mutual agreement procedure (MAP) available under most bilateral tax treaties. TEI recommends that the OECD strengthen the language in these paragraphs to further heighten the awareness of the availability of the MAP process to resolve disputes, as well as the importance of the elimination of double taxation to an effective, efficient, and certain tax system.

As a threshold matter, it would be useful if the guidance in the Discussion Draft included a list of features that indicate what is *not* considered an HTVI. While what is and is not considered an intangible asset has been the subject of much discussion before and during the BEPS project, with many definitional issues still unresolved, it would assist taxpayers and tax authorities in applying the Discussion Draft guidance to have some direction on when an intangible might be considered an HTVI or, alternatively, when it should not be so considered. Even a short list of factors would be helpful in this area.

TEI acknowledges the 2015 Final Report for Actions 8-10 of the BEPS project recommended, *inter alia*, the materiality measurement and time periods contained in the current exemptions be reviewed by 2020 in light of further experience, as noted in Paragraph 4 of the Draft. In the light of this commitment, TEI recommends that in the interim the OECD provide additional detailed guidance related to these exemptions, as many multi-national enterprises (MNEs) will address these issues in the immediate future.

In addition, we note that a high degree of subjectivity will inevitably be applied to an HTVI analysis, particularly as actual outcomes will be available on audit by tax authorities. Thus, TEI recommends any guidance intended to establish a common understanding amongst tax administrations and provide for consistent application of the HTVI approach be sufficiently detailed to ensure proposed adjustments are based on arm's length data available contemporaneously with a particularly transaction, rather than purely through hindsight.

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<sup>1</sup> TEI is a corporation organized 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).

Guidance related to HTVI should also include more clarity on the relationship with other published guidance, including the recently updated OECD commentary on transactional profit splits of anticipated profits. We anticipate that there will be overlap in the two areas so additional guidance should address any links to ensure consistency and clarity.

Paragraph 5 of the Discussion Draft refers to the concern of many tax authorities of information asymmetries between taxpayers and tax administrators. TEI recommends the OECD provide guidance in this area by introducing an element of “proportionality” into any efforts to address this issue. Such guidance should include materiality thresholds so that the proportionality of efforts to remedy any information asymmetries is tied to the size of a specific transaction. Taxpayers do not have the benefit of hindsight when making business decisions and assessing business risk. Taxpayers must make investment and operational decisions with the information available to them at the time and do not, and indeed are generally prohibited from, adjusting transfer prices retroactively based on hindsight if, for example, the taxpayer has erroneously overvalued an intangible. TEI recommends that the Discussion Draft acknowledge this point to assist tax authorities’ understanding of the *ex ante* informational constraints MNEs face when making business decisions and setting transfer prices.

The guidance in the Discussion Draft also addresses the requirement to assess what conditions would have been established *ex ante* at arm’s length. However, it appears the language included in the Discussion Draft, which references paragraph 6.192 of the OECD Transfer Pricing Guidelines, creates a significant risk that the guidance in the Draft will be interpreted as permitting tax authorities to choose a different pricing method *ex post*. TEI strongly recommends 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.

In addition, there is little current guidance on how far back in time tax authorities may use hindsight to assess the need for an HTVI adjustment. To provide some measure of certainty, the guidance should recommend countries’ statutes of limitation that would 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, but that after this date has passed, the earlier years would be treated as permanently closed for further adjustments.

TEI also recommends the OECD make clear the guidance in the Discussion Draft is only applicable prospectively to taxpayers and transactions taking place sometime after the OECD issues guidance in final form. That is, the guidance should explicitly bar retroactive application of the new rules by tax authorities to past transactions. This would permit taxpayers to adjust their operations and transfer prices to the new guidance and ensure taxpayers are not subject to double taxation under contracts and transfer pricing approaches that were in place before the new rules. Prospective application of the rules would also increase tax certainty for taxpayers

and tax authorities. This would be in accord with the OECD's and International Monetary Fund's (IMF) recent focus on the impact of tax certainty – and uncertainty – on cross-border trade and investment.<sup>2</sup> TEI agrees with the OECD and IMF that certainty in tax matters is a critical consideration for MNEs when determining whether to enter a particular market and other strategic business decisions.

#### Comments Regarding Examples in the Draft

While TEI welcomes the examples in the Discussion Draft, the examples are too simplistic and unidirectional to provide thorough guidance to taxpayers. TEI recommends the final version of the Draft include additional examples that reflect the complexity of business transactions, facts, and circumstances.

For example, TEI suggests that an additional example could be included as follows. The facts would be the same as in Example 1, paragraphs 17 and 18 of the Draft. In addition, sales from the intangible are assumed to be:

Year 4/Actual Sales:	200
Year 5/Actual Sales:	400
Year 6/Actual Sales:	800
Year 7/Estimated Sales:	1200
Year 8+/Projected Sales:	1500

In year 7, the tax authorities of Country A conduct an audit of years 4-6, obtain year 7 estimates, and years 8+ projections. The OECD should then explain what data can or should Country A tax authorities use to estimate the arm's length value of the intangible in year 0. Should such data be only the actual numbers (*i.e.*, the *ex post* results) or all of the information available, including estimates and revised future projections? Similarly for the estimate of arm's length value by tax authorities in Country S.

In addition, there should be at least one example where Country S tax authorities (tax authorities of the country purchasing the intangible) are conducting an audit and find the price paid in Year 0, or the royalty rate calculated in Year 0, exceeded the arm's length price. These tax authorities may have an interest in making a transfer pricing adjustment to either disallow the purchase price amortization or royalty rate exceeding the arm's length price, and/or assert that a constructive dividend took place that requires payment of a withholding tax.

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<sup>2</sup> See, e.g., [Tax Certainty: IMF/OECD Report for the G20 Finance Ministers](https://www.oecd.org/tax/tax-policy/tax-certainty-report-oecd-imf-report-g20-finance-ministers-march-2017.pdf), March 2017 available at <https://www.oecd.org/tax/tax-policy/tax-certainty-report-oecd-imf-report-g20-finance-ministers-march-2017.pdf> (noting “the importance of providing greater tax certainty to taxpayers to support trade, investment and economic growth”).

Finally, a couple examples illustrating the coordination of the statute of limitations and use of *ex post* outcomes to determine transfer prices would be helpful. This would be particularly useful for situations involving lump sum payments and royalty payments.

**Conclusion**

TEI appreciates the opportunity to comment on the Discussion Draft regarding implementation guidance on hard-to-value intangibles. 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](mailto:nickhasen@sbcglobal.net), or Benjamin R. Shreck of the Institute's legal staff, at +1 202 464 8353, [bshreck@tei.org](mailto:bshreck@tei.org).

Sincerely yours,  
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