Transfer Pricing Alert

OECD issues discussion draft on hard-to-value intangibles

On June 4, 2015, the Organization for Economic Cooperation and Development (OECD) released a non-consensus discussion draft on Action 8 of its base erosion and profits shifting (BEPS) plan regarding hard-to-value intangibles (hereinafter referred to as "HTVI").

Arm's length pricing when valuation is highly uncertain at time of transaction

The discussion draft states that, when valuation of an intangible or rights corresponding to an intangible is highly uncertain at the time of the transaction, and questions arise as to how arm's length pricing should be determined, the questions should be answered by reference to what independent enterprises would have done "to take account of the valuation uncertainty."

According to the discussion draft, there are a number of pricing arrangements that independent parties may agree upon, depending on the facts and circumstances. In cases when subsequent developments are sufficiently predictable to make forecasts reliable, independent parties may use projections of anticipated benefits to fix a price (ex ante pricing) at the outset of the transaction, regardless of the eventual outcome of the benefits.

The discussion draft identifies the difficulties tax authorities face in verifying the developments or events that the parties could or should have taken into account when the pricing was determined. It suggests that information asymmetry between tax authorities and businesses regarding the business and its environment may give rise to a risk of systematic mispricing.

Hard-to-value intangibles

The discussion draft sets out features for HTVI that may be subject to special considerations. HTVIs are intangibles for which, at the time of their transfer between group companies, (i) no sufficiently reliable comparables exist; and (ii) there is a lack of reliable projections of future cash flows or income expected to be derived from the transferred intangible, or the assumptions used in valuing the intangible are highly uncertain.

Intangibles that fall within the category of HTVIs may exhibit one or more of the following features:

- Intangibles that are only partially developed at the time of the transfer;
- Intangibles that are not anticipated to be exploited commercially until several years following the transaction;
- Intangibles that separately are not HTVI but that are connected with the development or enhancement of other intangibles that fall within the category of HTVI;
- Intangibles that are anticipated to be exploited in a manner that is novel at the time of the transfer.

Conclusion

The Discussion Draft issued by OECD responds to the requirement under Action 8 to develop an approach to hard-to-value intangibles and proposes revisions to the existing guidance. The proposed new guidance is addressed to both taxpayers and tax authorities and contains principles to be considered and a recommended process to be followed in accurately determining the arm's length pricing of an intangible at the time when the transaction takes place.

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