ICC Comments on BEPS Action 8 Implementation Guidance on Hard-to-Value Intangibles (Public Discussion Draft)

ICC appreciates the opportunity to comment on the Implementation Guidance on Hard-to-Value Intangibles Discussion Draft. Hard-to-Value Intangibles (HTVI) are a frequent source of international tax disputes, leading to double taxation. This situation is especially worrisome as HTVI are a core feature of the digital economy. ICC therefore welcomes the OECD initiative to provide for an international standard.

ICC acknowledges the aim of the Discussion Draft in seeking to protect tax authorities in the event that they may be risk assessing and auditing transfers of HTVIs where currently the information provided may be insufficient to make an informed assessment. In addition, the guidance clearly increases the probability that tax payers would furnish greater levels of information to tax authorities.

ICC also acknowledges that the guidance is likely to encourage tax payers to ensure that before entering into pricing arrangements, they would consider alternative pricing arrangements (e.g. contingent payments, milestone payments, price adjustment clauses) which may lead to more accurate pricing models in certain circumstances.

The Discussion Draft describes a method in which tax administrations would be able to consider ex post outcomes as presumptive evidence regarding the appropriateness of the ex-ante pricing arrangements. This would enable tax authorities to use the ex post outcomes to revise the original transfer value of the HTVI several years after the transfer has taken place. In such cases, ICC is concerned that this adjustment may lead to double taxation and more tax disputes.

Furthermore, the proposed guidance on HTVI aims at making sure that the impact of an unexpected event can be corrected ex post so that the outcome of a transaction is always equitable. This search for ex post equity is not only subjective but can have potentially negative effects. It departs from the comparison with free market terms, as when independent third parties contract together, there is no guarantee that the deal will result equitably for them. Removing that risk from HTVI transactions would apply a different standard to intercompany transactions than to independent ones. In effect, this moves from the transfer pricing standard of arm's length to "international tax equity". It is essential for the international business community that the arm's length standard remains the backbone of transfer pricing guidance for a balanced international tax system[1].

In addition, a shift from "market price" to "equitable outcome" will reduce legal certainty for tax payers, as the notion of equity cannot be precisely defined. By enabling the tax authorities to wait until ex post outcomes are available, the taxpayer may be at a disadvantage, given that there would be no certainty on the future sales figures or profitability of a given product.

This would also create a system whereby international investors would only secure certainty regarding a tax liability years after the transactions have occurred. While the guidance aims to protect tax authorities, presumably there is no recourse for the taxpayers should the transfer price actually be too high once ex post outcomes are considered. Due to local statutory time limits, and the inability in certain territories to make downwards transfer pricing adjustments, it is unlikely that a feasible recourse would be available to taxpayers.

In many cases, the effective profit generated by an HTVI differs from the expectations of the parties reflected in their commercial agreement, without any renegotiation or restatement of the initial equilibrium being provided for. Therefore, the belief that an ex-post analysis is necessary to bring the tax position into line with the commercial reality is debatable.

Different HTVI business stages and valuation methods can have a significant impact on HTVI valuation. As such, ICC would like to signal the benefit of establishing empirical and reasonable

[1] HTVI should be tested only at the time of the transaction, based on a reasonably expected outcome.

valuation methods for tax administrations to adopt, to ensure the recommended method remains reasonable and consistent. For example, it may recommend the use of more than one valuation method to verify the reasonableness of an outcome, as opposed to using a single method.

Moreover, ICC is concerned with the proposal related to the burden of proof. It is our understanding from the Draft that taxpayers will need to demonstrate that all potential outcomes of the HTVI have been considered in the initial transactions.[2] From a general stand point, it is a common approach under transfer pricing rules to gather information and prepare contemporaneous documentation to sustain the choice of the taxpayer. ICC believes that the same rule should apply here. ICC considers that the protection against arbitrary reversal of proof is a right of any international investor. Therefore, as long as sufficient contemporaneous documentation is provided during a tax audit, the burden of proof should remain on the tax administration.

Given that tax authority audits could take place in years 4 or 5 following the transaction, there is a significant risk that any adjustment using ex post outcomes could result in significant interest and penalties for the taxpayer. We recommend that the OECD guidance clarify this point as there could be circumstances where it would be unfair to levy penalties where a good faith effort was made to price a transfer correctly and relevant documentation was in place to support the transfer.

ICC acknowledges that the HTVI guidance should not apply where the taxpayer has disclosed significant information (e.g. details of ex ante projections, how risks were factored in, appropriate considerations of “reasonably foreseeable events” etc.). However the guidance does not clarify how the threshold for information disclosure will be met. To this end a template of information required to give taxpayers clarity on these requirements would be desired to avoid increasing the administrative burden for the taxpayer.

The examples given are not wide-ranging for different industries, and do not appear to cover a scenario where the taxpayer does encounter an “unforeseeable event”. In the two papers published, the only reference to an “unforeseeable event” appears to be a natural disaster which has a low probability of occurrence. It would be helpful to provide a more diverse range of examples of unforeseen events, so taxpayers can gauge what scenarios need to be considered in their valuations.

Further, ICC would propose that the OECD take into account the varying levels of sophistication of tax administrations across the globe as well as their capabilities with respect to valuation of enterprises and to establish HTVI valuation methods and detailed implementation guidance accordingly. In addition, cases to serve as reference points in guiding tax administrations and multinational enterprises to properly conduct transfer pricing of HTVI would be useful in this regard.

The consultation draft states that the practical application of the exemptions listed will be reviewed by 2020 in light of further experience. Whilst the potential future flexibility could be useful once the guidance has been implemented, this could lead to further uncertainty for taxpayers, especially if at an early stage they need to consider whether a bilateral APA is the most appropriate approach to take to minimise the future risk of ex post adjustments.

[2] ICC believes that the taxpayer should only have to prove that the analysis was made in good faith, based on the information available at the time of the transaction and that the onus should be on the tax authorities to demonstrate that the taxpayer’s analyses were inaccurate and below the common standard of normal diligence / forecasts for such a transaction.

The International Chamber of Commerce (ICC)

Commission on Taxation

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The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.