

Chapter VI

Special considerations for intangibles

6.1. Under Article 9 of the OECD Model Tax Convention, where the conditions made or imposed in the use or transfer of intangibles between two associated enterprises differ from those that would be made between independent enterprises, then any profits that would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

6.2. The purpose of this Chapter VI is to provide guidance specially tailored to determining arm's length conditions for transactions that involve the use or transfer of intangibles. Article 9 of the OECD Model Tax Convention is concerned with the conditions of transactions between associated enterprises, not with assigning particular labels to such transactions. Consequently, the key consideration is whether a transaction conveys economic value from one associated enterprise to another, whether that benefit derives from tangible property, intangibles, services or other items or activities. An item or activity can convey economic value notwithstanding the fact that it may not be specifically addressed in Chapter VI. To the extent that an item or activity conveys economic value, it should be taken into account in the determination of arm's length prices whether or not it constitutes an intangible within the meaning of paragraph 6.6.

6.3. The principles of Chapters I-III of these Guidelines apply equally to transactions involving intangibles and those transactions which do not. Under those principles, as is the case with other transfer pricing matters, the analysis of cases involving the use or transfer of intangibles should begin with a thorough identification of the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the actual transaction involving the use or transfer of intangibles is accurately delineated. The functional analysis should identify the functions performed, assets used,

and risks assumed¹ by each relevant member of the MNE group. In cases involving the use or transfer of intangibles, it is especially important to ground the functional analysis on an understanding of the MNE's global business and the manner in which intangibles are used by the MNE to add or create value across the entire supply chain. Where necessary, the analysis should consider, within the framework of Section D.2 of Chapter I, whether independent parties would have entered into the arrangement and if so, the conditions that would have been agreed.

6.4. In order to determine arm's length conditions for the use or transfer of intangibles it is important to perform a functional and comparability analysis in accordance with Section D.1 of Chapter I, based on identifying the intangibles and associated risks in contractual arrangements and then supplementing the analysis through examination of the actual conduct of the parties based on the functions performed, assets used, and risks assumed, including control of important functions and economically significant risks. Accordingly the next section, Section A, provides guidance on identifying intangibles. Section B examines legal ownership and other contractual terms, together with guidance on the evaluation of the conduct of the parties based on functions, assets and risks. Section C outlines some typical scenarios involving intangibles, and Section D provides guidance on determining arm's length conditions including the application of pricing methods and valuation techniques, and provides an approach to determining arm's length conditions for a specific category of hard-to-value intangibles. Examples illustrating the guidance are contained in the Annex to this chapter.

A. Identifying intangibles

A.1. In general

6.5. Difficulties can arise in a transfer pricing analysis as a result of definitions of the term intangible that are either too narrow or too broad. If an overly narrow definition of the term intangible is applied, either taxpayers or governments may argue that certain items fall outside the definition and may therefore be transferred or used without separate compensation, even though such use or transfer would give rise to compensation in transactions between independent enterprises. If too broad a definition is applied, either taxpayers or governments may argue that the use or transfer of an item in transactions

1. The assumption of risks refers to the outcome of the determination of which associated enterprise assumes a specific risk under the guidance provided in Section D.1.2.1 of Chapter I, taking into account control over risk and financial capacity to assume the risk. Contractual assumption of risk refers to the allocation of risk in contracts between the parties.

between associated enterprises should require compensation in circumstances where no such compensation would be provided in transactions between independent enterprises.

6.6. In these Guidelines, therefore, the word “intangible” is intended to address something which is not a physical asset or a financial asset,² which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances. Rather than focusing on accounting or legal definitions, the thrust of a transfer pricing analysis in a case involving intangibles should be the determination of the conditions that would be agreed upon between independent parties for a comparable transaction.

6.7. Intangibles that are important to consider for transfer pricing purposes are not always recognised as intangible assets for accounting purposes. For example, costs associated with developing intangibles internally through expenditures such as research and development and advertising are sometimes expensed rather than capitalised for accounting purposes and the intangibles resulting from such expenditures therefore are not always reflected on the balance sheet. Such intangibles may nevertheless be used to generate significant economic value and may need to be considered for transfer pricing purposes. Furthermore, the enhancement to value that may arise from the complementary nature of a collection of intangibles when exploited together is not always reflected on the balance sheet. Accordingly, whether an item should be considered to be an intangible for transfer pricing purposes under Article 9 of the OECD Model Tax Convention can be informed by its characterisation for accounting purposes, but will not be determined by such characterisation only. Furthermore, the determination that an item should be regarded as an intangible for transfer pricing purposes does not determine or follow from its characterisation for general tax purposes, as, for example, an expense or an amortisable asset.

6.8. The availability and extent of legal, contractual, or other forms of protection may affect the value of an item and the returns that should be attributed to it. The existence of such protection is not, however, a necessary condition for an item to be characterised as an intangible for transfer pricing purposes. Similarly, while some intangibles may be identified separately and transferred on a segregated basis, other intangibles may be transferred only

2. As used in this paragraph, a financial asset is any asset that is cash, an equity instrument, a contractual right or obligation to receive cash or another financial asset or to exchange financial assets or liabilities, or a derivative. Examples include bonds, bank deposits, stocks, shares, forward contracts, futures contracts and swaps.

in combination with other business assets. Therefore, separate transferability is not a necessary condition for an item to be characterised as an intangible for transfer pricing purposes.

6.9. It is important to distinguish intangibles from market conditions or local market circumstances. Features of a local market, such as the level of disposable income of households in that market or the size or relative competitiveness of the market are not capable of being owned or controlled. While in some circumstances they may affect the determination of an arm's length price for a particular transaction and should be taken into account in a comparability analysis, they are not intangibles for the purposes of Chapter VI. See Section D.6 of Chapter I.

6.10. The identification of an item as an intangible is separate and distinct from the process for determining the price for the use or transfer of the item under the facts and circumstances of a given case. Depending on the industry sector and other facts specific to a particular case, exploitation of intangibles can account for either a large or small part of the MNE's value creation. It should be emphasised that not all intangibles deserve compensation separate from the required payment for goods or services in all circumstances, and not all intangibles give rise to premium returns in all circumstances. For example, consider a situation in which an enterprise performs a service using non-unique know-how, where other comparable service providers have comparable know-how. In that case, even though know-how constitutes an intangible, it may be determined under the facts and circumstances that the know-how does not justify allocating a premium return to the enterprise, over and above normal returns earned by comparable independent providers of similar services that use comparable non-unique know-how. See Section D.1.3 of Chapter I. See also paragraph 6.17 for a definition of "unique" intangibles.

6.11. Care should be taken in determining whether or when an intangible exists and whether an intangible has been used or transferred. For example, not all research and development expenditures produce or enhance an intangible, and not all marketing activities result in the creation or enhancement of an intangible.

6.12. In a transfer pricing analysis of a matter involving intangibles, it is important to identify the relevant intangibles with specificity. The functional analysis should identify the relevant intangibles at issue, the manner in which they contribute to the creation of value in the transactions under review, the important functions performed and specific risks assumed in connection with the development, enhancement, maintenance, protection and exploitation of the intangibles and the manner in which they interact with other intangibles, with tangible assets and with business operations to create value. While it may be appropriate to aggregate intangibles for the purpose of determining

arm's length conditions for the use or transfer of the intangibles in certain cases, it is not sufficient to suggest that vaguely specified or undifferentiated intangibles have an effect on arm's length prices or other conditions. A thorough functional analysis, including an analysis of the importance of identified relevant intangibles in the MNE's global business, should support the determination of arm's length conditions.

A.2. Relevance of this chapter for other tax purposes

6.13. The guidance contained in this chapter is intended to address transfer pricing matters exclusively. It is not intended to have relevance for other tax purposes. For example, the Commentary on Article 12 of the OECD Model Tax Convention contains a detailed discussion of the definition of royalties under that Article (paragraphs 8 to 19). The Article 12 definition of “royalties” is not intended to provide any guidance on whether, and if so at what price, the use or transfer of intangibles would be remunerated between independent parties. It is therefore not relevant for transfer pricing purposes. Moreover, the manner in which a transaction is characterised for transfer pricing purposes has no relevance to the question of whether a particular payment constitutes a royalty or may be subjected to withholding tax under Article 12. The concept of intangibles for transfer pricing purposes and the definition of royalties for purposes of Article 12 of the OECD Model Tax Convention are two different notions that do not need to be aligned. It may occur that a payment made between associated enterprises may be regarded as not constituting a royalty for purposes of Article 12, and nevertheless be treated for transfer pricing purposes as a payment to which the principles of this chapter may apply. Examples could include certain payments related to goodwill or ongoing concern value. It may also occur that a payment properly treated as a royalty under Article 12 of a relevant Treaty may not be made in remuneration for intangibles for purposes of this chapter. Examples could include certain payments for technical services. Similarly, the guidance in this chapter is not intended to have relevance for customs purposes.

6.14. The guidance in this chapter is also not relevant to recognition of income, capitalisation of intangible development costs, amortisation, or similar matters. Thus, for example, a jurisdiction may choose not to impose tax on the transfer of particular types of intangibles under specified circumstances. Similarly, a jurisdiction may not permit amortisation of the cost of certain acquired items that would be considered intangibles under the definitions in this chapter and whose transfer may be subjected to tax at the time of the transfer in the transferor's jurisdiction. It is recognised that inconsistencies between individual jurisdictional laws regarding such matters can sometimes give rise to either double taxation or double non-taxation.

A.3. Categories of intangibles

6.15. In discussions of transfer pricing issues related to intangibles, it is sometimes the case that various categories of intangibles are described and labels applied. Distinctions are sometimes made between trade intangibles and marketing intangibles, between “soft” intangibles and “hard” intangibles, between routine and non-routine intangibles, and between other classes and categories of intangibles. The approach contained in this chapter for determining arm’s length prices in cases involving intangibles does not turn on these categorisations. Accordingly, no attempt is made in these Guidelines to delineate with precision various classes or categories of intangibles or to prescribe outcomes that turn on such categories.

6.16. Certain categories of intangibles are, however, commonly referred to in discussions of transfer pricing matters. To facilitate discussions, definitions of two such commonly used terms, “marketing intangibles” and “trade intangibles” are contained in the Glossary and referred to from time to time in the discussion in these Guidelines. It should be emphasised that generic references to marketing or trade intangibles do not relieve taxpayers or tax administrations from their obligation in a transfer pricing analysis to identify relevant intangibles with specificity, nor does the use of those terms suggest that a different approach should be applied in determining arm’s length conditions for transactions that involve either marketing intangibles or trade intangibles.

6.17. In certain instances these Guidelines refer to “unique and valuable” intangibles. “Unique and valuable” intangibles are those intangibles (i) that are not comparable to intangibles used by or available to parties to potentially comparable transactions, and (ii) whose use in business operations (e.g. manufacturing, provision of services, marketing, sales or administration) is expected to yield greater future economic benefits than would be expected in the absence of the intangible.

A.4. Illustrations

6.18. This section provides illustrations of items often considered in transfer pricing analyses involving intangibles. The illustrations are intended to clarify the provisions of Section A.1, but this listing should not be used as a substitute for a detailed analysis. The illustrations are not intended to be comprehensive or to provide a complete listing of items that may or may not constitute intangibles. Numerous items not included in this listing of illustrations may be intangibles for transfer pricing purposes. The illustrations in this section should be adapted to the specific legal and regulatory environment that prevails in each jurisdiction. Furthermore, the illustrations in this section should be considered and evaluated in the context of the comparability analysis (including the functional analysis) of the controlled transaction with

the objective of better understanding how specific intangibles and items not treated as intangibles contribute to the creation of value in the context of the MNE's global business. It should be emphasised that a generic reference to an item included in the list of illustrations does not relieve taxpayers or tax administrations from their obligation in a transfer pricing analysis to identify relevant intangibles with specificity based on the guidance of Section A.1.

A.4.1. Patents

6.19. A patent is a legal instrument that grants an exclusive right to its owner to use a given invention for a limited period of time within a specific geography. A patent may relate to a physical object or to a process. Patentable inventions are often developed through risky and costly research and development activities. In some circumstances, however, small research and development expenditures can lead to highly valuable patentable inventions. The developer of a patent may try to recover its development costs (and earn a return) through the sale of products covered by the patent, by licensing others to use the patented invention, or by an outright sale of the patent. The exclusivity granted by a patent may, under some circumstances, allow the patent owner to earn premium returns from the use of its invention. In other cases, a patented invention may provide cost advantages to the owner that are not available to competitors. In still other situations, patents may not provide a significant commercial advantage. Patents are intangibles within the meaning of Section A.1.

A.4.2. Know-how and trade secrets

6.20. Know-how and trade secrets are proprietary information or knowledge that assist or improve a commercial activity, but that are not registered for protection in the manner of a patent or trademark. Know-how and trade secrets generally consist of undisclosed information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise. Know-how and trade secrets may relate to manufacturing, marketing, research and development, or any other commercial activity. The value of know-how and trade secrets is often dependent on the ability of the enterprise to preserve the confidentiality of the know-how or trade secret. In certain industries the disclosure of information necessary to obtain patent protection could assist competitors in developing alternative solutions. Accordingly, an enterprise may, for sound business reasons, choose not to register patentable know-how, which may nonetheless contribute substantially to the success of the enterprise. The confidential nature of know-how and trade secrets may be protected to some degree by (i) unfair competition or similar laws, (ii) employment contracts, and (iii) economic and technological barriers to competition. Know-how and trade secrets are intangibles within the meaning of Section A.1.

A.4.3. Trademarks, trade names and brands

6.21. A trademark is a unique name, symbol, logo or picture that the owner may use to distinguish its products and services from those of other entities. Proprietary rights in trademarks are often confirmed through a registration system. The registered owner of a trademark may exclude others from using the trademark in a manner that would create confusion in the marketplace. A trademark registration may continue indefinitely if the trademark is continuously used and the registration appropriately renewed. Trademarks may be established for goods or services, and may apply to a single product or service, or to a line of products or services. Trademarks are perhaps most familiar at the consumer market level, but they are likely to be encountered at all market levels. Trademarks are intangibles within the meaning of Section A.1.

6.22. A trade name (often but not always the name of an enterprise) may have the same force of market penetration as a trademark and may indeed be registered in some specific form as a trademark. The trade names of certain MNEs may be readily recognised, and may be used in marketing a variety of goods and services. Trade names are intangibles within the meaning of Section A.1.

6.23. The term “brand” is sometimes used interchangeably with the terms “trademark” and “trade name.” In other contexts a brand is thought of as a trademark or trade name imbued with social and commercial significance. A brand may, in fact, represent a combination of intangibles and/or other items, including among others, trademarks, trade names, customer relationships, reputational characteristics, and goodwill. It may sometimes be difficult or impossible to segregate or separately transfer the various items contributing to brand value. A brand may consist of a single intangible, or a collection of intangibles, within the meaning of Section A.1.

A.4.4. Rights under contracts and government licences

6.24. Government licences and concessions may be important to a particular business and can cover a wide range of business relationships. They may include, among others, a government grant of rights to exploit specific natural resources or public goods (e.g. a licence of bandwidth spectrum), or to carry on a specific business activity. Government licences and concessions are intangibles within the meaning of Section A.1. However, government licences and concessions should be distinguished from company registration obligations that are preconditions for doing business in a particular jurisdiction. Such obligations are not intangibles within the meaning of Section A.1.

6.25. Rights under contracts may also be important to a particular business and can cover a wide range of business relationships. They may include, among others, contracts with suppliers and key customers, and agreements to

make available the services of one or more employees. Rights under contracts are intangibles within the meaning of Section A.1.

A.4.5. Licences and similar limited rights in intangibles

6.26. Limited rights in intangibles are commonly transferred by means of a licence or other similar contractual arrangement, whether written, oral or implied. Such licensed rights may be limited as to field of use, term of use, geography or in other ways. Such limited rights in intangibles are themselves intangibles within the meaning of Section A.1.

A.4.6. Goodwill and ongoing concern value

6.27. Depending on the context, the term goodwill can be used to refer to a number of different concepts. In some accounting and business valuation contexts, goodwill reflects the difference between the aggregate value of an operating business and the sum of the values of all separately identifiable tangible and intangible assets. Alternatively, goodwill is sometimes described as a representation of the future economic benefits associated with business assets that are not individually identified and separately recognised. In still other contexts goodwill is referred to as the expectation of future trade from existing customers. The term ongoing concern value is sometimes referred to as the value of the assembled assets of an operating business over and above the sum of the separate values of the individual assets. It is generally recognised that goodwill and ongoing concern value cannot be segregated or transferred separately from other business assets. See paragraphs 9.68-9.70 for a discussion of the related notion of a transfer of all of the elements of an ongoing concern in connection with a business restructuring.

6.28. It is not necessary for purposes of this chapter to establish a precise definition of goodwill or ongoing concern value for transfer pricing purposes or to define when goodwill or ongoing concern value may or may not constitute an intangible. It is important to recognise, however, that an important and monetarily significant part of the compensation paid between independent enterprises when some or all of the assets of an operating business are transferred may represent compensation for something referred to in one or another of the alternative descriptions of goodwill or ongoing concern value. When similar transactions occur between associated enterprises, such value should be taken into account in determining an arm's length price for the transaction. When the reputational value sometimes referred to by the term goodwill is transferred to or shared with an associated enterprise in connection with a transfer or licence of a trademark or other intangible that reputational value should be taken into account in determining appropriate compensation. If features of a business such as a reputation for producing high quality products or providing high quality service allow that business to charge higher prices

for goods or services than an entity lacking such reputation, and such features might be characterised as goodwill or ongoing concern value under one or another definition of such terms, such features should be taken into account in establishing arm's length prices for sales of goods or the provision of services between associated enterprises whether or not they are characterised as goodwill. In other words, labelling a contribution of value from one party to another as goodwill or ongoing concern value does not render such contribution non-compensable. See paragraph 6.2.

6.29. The requirement that goodwill and ongoing concern value be taken into account in pricing transactions in no way implies that the residual measures of goodwill derived for some specific accounting or business valuation purposes are necessarily appropriate measures of the price that would be paid for the transferred business or licence rights, together with their associated goodwill and ongoing concern value, by independent parties. Accounting and business valuation measures of goodwill and ongoing concern value do not, as a general rule, correspond to the arm's length price of transferred goodwill or ongoing concern value in a transfer pricing analysis. Depending on the facts and circumstances, however, accounting valuations and the information supporting such valuations can provide a useful starting point in conducting a transfer pricing analysis. The absence of a single precise definition of goodwill makes it essential for taxpayers and tax administrations to describe specifically relevant intangibles in connection with a transfer pricing analysis, and to consider whether independent enterprises would provide compensation for such intangibles in comparable circumstances.

A.4.7. Group synergies

6.30. In some circumstances group synergies contribute to the level of income earned by an MNE group. Such group synergies can take many different forms including streamlined management, elimination of costly duplication of effort, integrated systems, purchasing or borrowing power, etc. Such features may have an effect on the determination of arm's length conditions for controlled transactions and should be addressed for transfer pricing purposes as comparability factors. As they are not owned or controlled by an enterprise, they are not intangibles within the meaning of Section A.1. See Section D.8 of Chapter I for a discussion of the transfer pricing treatment of group synergies.

A.4.8. Market specific characteristics

6.31. Specific characteristics of a given market may affect the arm's length conditions of transactions in that market. For example, the high purchasing power of households in a particular market may affect the prices paid for certain luxury consumer goods. Similarly, low prevailing labour costs,

proximity to markets, favourable weather conditions and the like may affect the prices paid for specific goods and services in a particular market. Such market specific characteristics are not capable, however, of being owned or controlled, and are therefore not intangibles within the meaning of Section A.1, and should be taken into account in a transfer pricing analysis through the required comparability analysis. See Section D.6 of Chapter I for guidance regarding the transfer pricing treatment of market specific characteristics.

B. Ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles

6.32. In transfer pricing cases involving intangibles, the determination of the entity or entities within an MNE group which are ultimately entitled to share in the returns derived by the group from exploiting intangibles is crucial.³ A related issue is which entity or entities within the group should ultimately bear the costs, investments and other burdens associated with the development, enhancement, maintenance, protection and exploitation of intangibles. Although the legal owner of an intangible may receive the proceeds from exploitation of the intangible, other members of the legal owner's MNE group may have performed functions, used assets,⁴ or assumed risks that are expected to contribute to the value of the intangible. Members of the MNE group performing such functions, using such assets, and assuming such risks must be compensated for their contributions under the arm's length principle. This Section B confirms that the ultimate allocation of the returns derived by the MNE group from the exploitation of intangibles, and the ultimate allocation of costs and other burdens related to intangibles among members of the MNE group, is accomplished by compensating members of the MNE group for functions performed, assets used, and risks assumed in the development, enhancement, maintenance, protection and exploitation of intangibles according to the principles described in Chapters I-III.

6.33. Applying the provisions of Chapters I-III to address these questions can be highly challenging for a number of reasons. Depending on the facts of any given case involving intangibles the following factors, among others, can create challenges:

3. As used herein, exploitation of an intangible includes both the transfer of the intangible or rights in the intangible and the use of the intangible in commercial operations.
4. As used in this Section B, the use of assets includes the contribution of funding and/or capital to the development, enhancement, maintenance, protection or exploitation of intangibles. See paragraph 6.59.

- i) A lack of comparability between the intangible related transactions undertaken between associated enterprises and those transactions that can be identified between independent enterprises;
- ii) A lack of comparability between the intangibles in question;
- iii) The ownership and/or use of different intangibles by different associated enterprises within the MNE group;
- iv) The difficulty of isolating the impact of any particular intangible on the MNE group's income;
- v) The fact that various members of an MNE group may perform activities relating to the development, enhancement, maintenance, protection and exploitation of an intangible, often in a way and with a level of integration that is not observed between independent enterprises;
- vi) The fact that contributions of various members of the MNE group to intangible value may take place in years different than the years in which any associated returns are realised; and
- vii) The fact that taxpayer structures may be based on contractual terms between associated enterprises that separate ownership, the assumption of risk, and/or funding of investments in intangibles from performance of important functions, control over risk, and decisions related to investment in ways that are not observed in transactions between independent enterprises and that may contribute to base erosion and profit shifting.

Notwithstanding these potential challenges, applying the arm's length principle and the provisions of Chapters I-III within an established framework can, in most cases, yield an appropriate allocation of the returns derived by the MNE group from the exploitation of intangibles.

6.34. The framework for analysing transactions involving intangibles between associated enterprises requires taking the following steps, consistent with the guidance for identifying the commercial or financial relations provided in Section D.1 of Chapter I:

- i) Identify the intangibles used or transferred in the transaction with specificity and the specific, economically significant risks associated with the development, enhancement, maintenance, protection, and exploitation of the intangibles;
- ii) Identify the full contractual arrangements, with special emphasis on determining legal ownership of intangibles based on the terms and conditions of legal arrangements, including relevant registrations, licence agreements, other relevant contracts, and other indicia of legal ownership, and the contractual rights and obligations, including contractual assumption of risks in the relations between the associated enterprises;

- iii) Identify the parties performing functions (including specifically the important functions described in paragraph 6.56), using assets, and managing risks related to developing, enhancing, maintaining, protecting, and exploiting the intangibles by means of the functional analysis, and in particular which parties control any outsourced functions, and control specific, economically significant risks;
- iv) Confirm the consistency between the terms of the relevant contractual arrangements and the conduct of the parties, and determine whether the party assuming economically significant risks under step 4 (i) of paragraph 1.60, controls the risks and has the financial capacity to assume the risks relating to the development, enhancement, maintenance, protection, and exploitation of the intangibles;
- v) Delineate the actual controlled transactions related to the development, enhancement, maintenance, protection, and exploitation of intangibles in light of the legal ownership of the intangibles, the other relevant contractual relations under relevant registrations and contracts, and the conduct of the parties, including their relevant contributions of functions, assets and risks, taking into account the framework for analysing and allocating risk under Section D.1.2.1 of Chapter I;
- vi) Where possible, determine arm's length prices for these transactions consistent with each party's contributions of functions performed, assets used, and risks assumed, unless the guidance in Section D.2 of Chapter I applies.

B.1. Intangible ownership and contractual terms relating to intangibles

6.35. Legal rights and contractual arrangements form the starting point for any transfer pricing analysis of transactions involving intangibles. The terms of a transaction may be found in written contracts, public records such as patent or trademark registrations, or in correspondence and/or other communications among the parties. Contracts may describe the roles, responsibilities and rights of associated enterprises with respect to intangibles. They may describe which entity or entities provide funding, undertake research and development, maintain and protect intangibles, and perform functions necessary to exploit the intangibles, such as manufacturing, marketing and distribution. They may describe how receipts and expenses of the MNE associated with intangibles are to be allocated and may specify the form and amount of payment to all members of the group for their contributions. The prices and other conditions contained in such contracts may or may not be consistent with the arm's length principle.

6.36. Where no written terms exist, or where the facts of the case, including the conduct of the parties, differ from the written terms of any agreement between them or supplement these written terms, the actual transaction must be deduced from the facts as established, including the conduct of the parties (see Section D.1.1 of Chapter I). It is, therefore, good practice for associated enterprises to document their decisions and intentions regarding the allocation of significant rights in intangibles. Documentation of such decisions and intentions, including written agreements, should generally be in place at or before the time that associated enterprises enter into transactions leading to the development, enhancement, maintenance, protection, or exploitation of intangibles.

6.37. The right to use some types of intangibles may be protected under specific intellectual property laws and registration systems. Patents, trademarks and copyrights are examples of such intangibles. Generally, the registered legal owner of such intangibles has the exclusive legal and commercial right to use the intangible, as well as the right to prevent others from using or otherwise infringing the intangible. These rights may be granted for a specific geographic area and/or for a specific period of time.

6.38. There are also intangibles that are not protectable under specific intellectual property registration systems, but that are protected against unauthorised appropriation or imitation under unfair competition legislation or other enforceable laws, or by contract. Trade dress, trade secrets, and know-how may fall under this category of intangibles.

6.39. The extent and nature of the available protection under applicable law may vary from jurisdiction to jurisdiction, as may the conditions on which such protection is provided. Such differences can arise either from differences in substantive intellectual property law between jurisdictions, or from practical differences in local enforcement of such laws. For example, the availability of legal protection for some intangibles may be subject to conditions such as continued commercial use of the intangible or timely renewal of registrations. This means that in some circumstances or jurisdictions, the degree of protection for an intangible may be extremely limited either legally or in practice.

6.40. The legal owner will be considered to be the owner of the intangible for transfer pricing purposes. If no legal owner of the intangible is identified under applicable law or governing contracts, then the member of the MNE group that, based on the facts and circumstances, controls decisions concerning the exploitation of the intangible and has the practical capacity to restrict others from using the intangible will be considered the legal owner of the intangible for transfer pricing purposes.

6.41. In identifying the legal owner of intangibles, an intangible and any licence relating to that intangible are considered to be different intangibles for transfer pricing purposes, each having a different owner. See paragraph 6.26.

For example, Company A, the legal owner of a trademark, may provide an exclusive licence to Company B to manufacture, market, and sell goods using the trademark. One intangible, the trademark, is legally owned by Company A. Another intangible, the licence to use the trademark in connection with manufacturing, marketing and distribution of trademarked products, is legally owned by Company B. Depending on the facts and circumstances, marketing activities undertaken by Company B pursuant to its licence may potentially affect the value of the underlying intangible legally owned by Company A, the value of Company B's licence, or both.

6.42. While determining legal ownership and contractual arrangements is an important first step in the analysis, these determinations are separate and distinct from the question of remuneration under the arm's length principle. For transfer pricing purposes, legal ownership of intangibles, by itself, does not confer any right ultimately to retain returns derived by the MNE group from exploiting the intangible, even though such returns may initially accrue to the legal owner as a result of its legal or contractual right to exploit the intangible. The return ultimately retained by or attributed to the legal owner depends upon the functions it performs, the assets it uses, and the risks it assumes, and upon the contributions made by other MNE group members through their functions performed, assets used, and risks assumed. For example, in the case of an internally developed intangible, if the legal owner performs no relevant functions, uses no relevant assets, and assumes no relevant risks, but acts solely as a title holding entity, the legal owner will not ultimately be entitled to any portion of the return derived by the MNE group from the exploitation of the intangible other than arm's length compensation, if any, for holding title.

6.43. Legal ownership and contractual relationships serve simply as reference points for identifying and analysing controlled transactions relating to the intangible and for determining the appropriate remuneration to members of a controlled group with respect to those transactions. Identification of legal ownership, combined with the identification and compensation of relevant functions performed, assets used, and risks assumed by all contributing members, provides the analytical framework for identifying arm's length prices and other conditions for transactions involving intangibles. As with any other type of transaction, the analysis must take into account all of the relevant facts and circumstances present in a particular case and price determinations must reflect the realistic alternatives of the relevant group members. The principles of this paragraph are illustrated by Examples 1 to 6 in Annex I to Chapter VI.

6.44. Because the actual outcomes and manner in which risks associated with the development or acquisition of an intangible will play out over time are not known with certainty at the time members of the MNE group make decisions regarding intangibles, it is important to distinguish between (a) anticipated (or

ex ante) remuneration, which refers to the future income expected to be derived by a member of the MNE group at the time of a transaction; and (b) actual (or *ex post*) remuneration, which refers to the income actually earned by a member of the group through the exploitation of the intangible.

6.45. The terms of the compensation that must be paid to members of the MNE group that contribute to the development, enhancement, maintenance, protection and exploitation of intangibles is generally determined on an *ex ante* basis. That is, it is determined at the time transactions are entered into and before risks associated with the intangible play out. The form of such compensation may be fixed or contingent. The actual (*ex post*) profit or loss of the business after compensating other members of the MNE group may differ from these anticipated profits depending on how the risks associated with the intangible or the other relevant risks related to the transaction or arrangement actually play out. The accurately delineated transaction, as determined under Section D.1 of Chapter I, will determine which associated entity assumes such risks and accordingly will bear the consequences (costs or additional returns) when the risks materialise in a different manner to what was anticipated (see Section B.2.4).

6.46. An important question is how to determine the appropriate arm's length remuneration to members of a group for their functions, assets, and risks within the framework established by the taxpayer's contractual arrangements, the legal ownership of intangibles, and the conduct of the parties. Section B.2 discusses the application of the arm's length principle to situations involving intangibles. It focuses on the functions, assets and risks related to the intangibles. Unless stated otherwise, references to arm's length returns and arm's length remuneration in Section B.2 refer to anticipated (*ex ante*) returns and remuneration.

B.2. Functions, assets, and risks related to intangibles

6.47. As stated above, a determination that a particular group member is the legal owner of intangibles does not, in and of itself, necessarily imply that the legal owner is entitled to any income generated by the business after compensating other members of the MNE group for their contributions in the form of functions performed, assets used, and risks assumed.

6.48. In identifying arm's length prices for transactions among associated enterprises, the contributions of members of the group related to the creation of intangible value should be considered and appropriately rewarded. The arm's length principle and the principles of Chapters I-III require that all members of the group receive appropriate compensation for any functions they perform, assets they use, and risks they assume in connection with the development, enhancement, maintenance, protection, and exploitation of intangibles. It is therefore necessary to determine, by means of a functional

analysis, which member(s) perform and exercise control over development, enhancement, maintenance, protection, and exploitation functions, which member(s) provide funding and other assets, and which member(s) assume the various risks associated with the intangible. Of course, in each of these areas, this may or may not be the legal owner of the intangible. As noted in paragraph 6.133, it is also important in determining arm's length compensation for functions performed, assets used, and risks assumed to consider comparability factors that may contribute to the creation of value or the generation of returns derived by the MNE group from the exploitation of intangibles in determining prices for relevant transactions.

6.49. The relative importance of contributions to the creation of intangible value by members of the group in the form of functions performed, assets used and risks assumed will vary depending on the circumstances. For example, assume that a fully developed and currently exploitable intangible is purchased from a third party by a member of a group and exploited through manufacturing and distribution functions performed by other group members while being actively managed and controlled by the entity purchasing the intangible. It is assumed that this intangible would require no development, may require little or no maintenance or protection, and may have limited usefulness outside the area of exploitation intended at the time of the acquisition. There would be no development risk associated with the intangible, although there are risks associated with acquiring and exploiting the intangible. The key functions performed by the purchaser are those necessary to select the most appropriate intangible on the market, to analyse its potential benefits if used by the MNE group, and the decision to take on the risk-bearing opportunity through purchasing the intangible. The key asset used is the funding required to purchase the intangible. If the purchaser has the capacity and actually performs all the key functions described, including control of the risks associated with acquiring and exploiting the intangible, it may be reasonable to conclude that, after making arm's length payment for the manufacturing and distribution functions of other associated enterprises, the owner would be entitled to retain or have attributed to it any income or loss derived from the post-acquisition exploitation of the intangible. While the application of Chapters I-III may be fairly straightforward in such a simple fact pattern, the analysis may be more difficult in situations in which:

- i) Intangibles are self-developed by a multinational group, especially when such intangibles are transferred between associated enterprises while still under development;
- ii) Acquired or self-developed intangibles serve as a platform for further development; or
- iii) Other aspects, such as marketing or manufacturing are particularly important to value creation.

The generally applicable guidance below is particularly relevant for, and is primarily concerned with, these more difficult cases.

B.2.1. Performance and control of functions

6.50. Under the principles of Chapters I-III, each member of the MNE group should receive arm's length compensation for the functions it performs. In cases involving intangibles, this includes functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles. The identity of the member or members of the group performing functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles, therefore, is one of the key considerations in determining arm's length conditions for controlled transactions.

6.51. The need to ensure that all members of the MNE group are appropriately compensated for the functions they perform, the assets they contribute and the risks they assume implies that if the legal owner of intangibles is to be entitled ultimately to retain all of the returns derived from exploitation of the intangibles it must perform all of the functions, contribute all assets used and assume all risks related to the development, enhancement, maintenance, protection and exploitation of the intangible. This does not imply, however, that the associated enterprises constituting an MNE group must structure their operations regarding the development, enhancement, maintenance, protection or exploitation of intangibles in any particular way. It is not essential that the legal owner physically performs all of the functions related to the development, enhancement, maintenance, protection and exploitation of an intangible through its own personnel in order to be entitled ultimately to retain or be attributed a portion of the return derived by the MNE group from exploitation of the intangibles. In transactions between independent enterprises, certain functions are sometimes outsourced to other entities. A member of an MNE group that is the legal owner of intangibles could similarly outsource functions related to the development, enhancement, maintenance, protection or exploitation of intangibles to either independent enterprises or associated enterprises.

6.52. Where associated enterprises other than the legal owner perform relevant functions that are anticipated to contribute to the value of the intangibles, they should be compensated on an arm's length basis for the functions they perform under the principles set out in Chapters I-III. The determination of arm's length compensation for functional contributions should consider the availability of comparable uncontrolled transactions, the importance of the functions performed to the creation of intangible value, and the realistically available options of the parties. The specific considerations described in paragraphs 6.53 to 6.58 should also be taken into account.

6.53. In outsourcing transactions between independent enterprises, it is usually the case that an entity performing functions on behalf of the legal owner of the intangible that relate to the development, enhancement, maintenance, protection, and exploitation of the intangible will operate under the control of such legal owner (as discussed in paragraph 1.65). Because of the nature of the relationships between associated enterprises that are members of an MNE group, however, it may be the case that outsourced functions performed by associated enterprises will be controlled by an entity other than the legal owner of the intangibles. In such cases, the legal owner of the intangible should also compensate the entity performing control functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles on an arm's length basis. In assessing what member of the MNE group in fact controls the performance of the relevant functions, principles apply analogous to those for determining control over risk in Section D.1.2.1 of Chapter I. Assessing the capacity of a particular entity to exert control and the actual performance of such control functions will be an important part of the analysis.

6.54. If the legal owner neither controls nor performs the functions related to the development, enhancement, maintenance, protection or exploitation of the intangible, the legal owner would not be entitled to any ongoing benefit attributable to the outsourced functions. Depending on the facts, the arm's length compensation required to be provided by the legal owner to other associated enterprises performing or controlling functions related to the development, enhancement, maintenance, protection, or exploitation of intangibles may comprise any share of the total return derived from exploitation of the intangibles. A legal owner not performing any relevant function relating to the development, enhancement, maintenance, protection or exploitation of the intangible will therefore not be entitled to any portion of such returns related to the performance or control of functions relating to the development, enhancement, maintenance, protection or exploitation of the intangible. It is entitled to an arm's length compensation for any functions it actually performs, any assets it actually uses and risks it actually assumes. See Sections B.2.2 to B.2.3. In determining the functions it actually performs, assets it actually uses and the risks it actually assumes the guidance in Section D.1.2 of Chapter I is especially relevant.

6.55. The relative value of contributions to development, enhancement, maintenance, protection, and exploitation of intangibles varies depending on the particular facts of the case. The MNE group member(s) making the more significant contributions in a particular case should receive relatively greater remuneration. For example, a company that merely funds research and development should have a lower anticipated return than if it both funds and controls research and development. Other things being equal, a still higher anticipated return should be provided if the entity funds, controls, and

physically performs the research and development. See also the discussion of funding in Section B.2.2.

6.56. In considering the arm's length compensation for functional contributions of various members of the MNE group, certain important functions will have special significance. The nature of these important functions in any specific case will depend on the facts and circumstances. For self-developed intangibles, or for self-developed or acquired intangibles that serve as a platform for further development activities, these more important functions may include, among others, design and control of research and marketing programmes, direction of and establishing priorities for creative undertakings including determining the course of "blue-sky" research, control over strategic decisions regarding intangible development programmes, and management and control of budgets. For any intangible (i.e. for either self-developed or acquired intangibles) other important functions may also include important decisions regarding defence and protection of intangibles, and ongoing quality control over functions performed by independent or associated enterprises that may have a material effect on the value of the intangible. Those important functions usually make a significant contribution to intangible value and, if those important functions are outsourced by the legal owner in transactions between associated enterprises, the performance of those functions should be compensated with an appropriate share of the returns derived by the MNE group from the exploitation of intangibles.

6.57. Because it may be difficult to find comparable transactions involving the outsourcing of such important functions, it may be necessary to utilise transfer pricing methods not directly based on comparables, including transactional profit split methods and *ex ante* valuation techniques, to appropriately reward the performance of those important functions. Where the legal owner outsources most or all of such important functions to other group members, attribution to the legal owner of any material portion of the return derived from the exploitation of the intangibles after compensating other group members for their functions should be carefully considered taking into account the functions it actually performs, the assets it actually uses and the risks it actually assumes under the guidance in Section D.1.2 of Chapter I. Examples 16 and 17 in Annex I to Chapter VI illustrate the principles contained in this paragraph.

6.58. Because the important functions described in paragraph 6.56 are often instrumental in managing the different functions performed, assets used, and risks assumed that are key to the successful development, enhancement, maintenance, protection, or exploitation of intangibles, and are therefore essential to the creation of intangible value, it is necessary to carefully evaluate transactions between parties performing these important functions and other associated enterprises. In particular, the reliability of a one-sided transfer pricing method will be substantially reduced if the party or

parties performing significant portions of the important functions are treated as the tested party or parties. See Example 6.

B.2.2. Use of assets

6.59. Group members that use assets in the development, enhancement, maintenance, protection, and exploitation of an intangible should receive appropriate compensation for doing so. Such assets may include, without limitation, intangibles used in research, development or marketing (e.g. know-how, customer relationships, etc.), physical assets, or funding. One member of an MNE group may fund some or all of the development, enhancement, maintenance, and protection of an intangible, while one or more other members perform all of the relevant functions. When assessing the appropriate anticipated return to funding in such circumstances, it should be recognised that in arm's length transactions, a party that provides funding, but does not control the risks or perform other functions associated with the funded activity or asset, generally does not receive anticipated returns equivalent to those received by an otherwise similarly-situated investor who also performs and controls important functions and controls important risks associated with the funded activity. The nature and amount of compensation attributable to an entity that bears intangible-related costs, without more, must be determined on the basis of all the relevant facts, and should be consistent with similar funding arrangements among independent entities where such arrangements can be identified. See the guidance in Section D.1.2.1.6 of Chapter I, and in particular Example 3 in paragraphs 1.85 and 1.103, which illustrate a situation where the party providing funding does not control the financial risk associated with the funding.

6.60. Funding and risk-taking are integrally related in the sense that funding often coincides with the taking of certain risks (e.g. the funding party contractually assuming the risk of loss of its funds). The nature and extent of the risk assumed, however, will vary depending on the economically relevant characteristics of the transaction. The risk will, for example, be lower when the party to which the funding is provided has a high creditworthiness, or when assets are pledged, or when the investment funded is low risk, compared with the risk where the creditworthiness is lower, or the funding is unsecured, or the investment being funded is high risk. Moreover, the larger the amount of the funds provided, the larger the potential impact of the risk on the provider of the funding.

6.61. Under the principles of Section D.1.2 of Chapter I, the first step in a transfer pricing analysis in relation to risks is to identify the economically significant risks with specificity. When identifying risks in relation to an investment with specificity, it is important to distinguish between the financial risks that are linked to the funding provided for the investments and the

operational risks that are linked to the operational activities for which the funding is used, such as for example the development risk when the funding is used for developing a new intangible. Where a party providing funding exercises control over the financial risk associated with the provision of funding, without the assumption of, including the control over, any other specific risk, it could generally only expect a risk-adjusted return on its funding.

6.62. The contractual arrangements will generally determine the terms of the funding transaction, as clarified or supplemented by the economic characteristics of the transaction as reflected in the conduct of the parties.⁵ The return that would generally be expected by the funder should equal an appropriate risk-adjusted return. Such return can be determined, for example, based on the cost of capital or the return of a realistic alternative investment with comparable economic characteristics. In determining an appropriate return for the funding activities, it is important to consider the financing options realistically available to the party receiving the funds. There may be a difference between the return expected by the funder on an *ex ante* basis and the actual return received on an *ex post* basis. For example, when the funder provides a loan for a fixed amount at a fixed interest rate, the difference between the actual and expected returns will reflect the risk playing out that the borrower cannot make some or all of the payments due.

6.63. The extent and form of the activities that will be necessary to exercise control over the financial risk attached to the provision of funding will depend on the riskiness of the investment for the funder, taking into account the amount of money at stake and the investment for which these funds are used. In accordance with the definition of control as reflected in paragraphs 1.65 and 1.66 of these Guidelines, exercising control over a specific financial risk requires the capability to make the relevant decisions related to the risk bearing opportunity, in this case the provision of the funding, together with the actual performance of these decision making functions. In addition, the party exercising control over the financial risk must perform the activities as indicated in paragraph 1.65 and 1.66 in relation to the day-to-day risk mitigation activities related to these risks when these are outsourced and related to any preparatory work necessary to facilitate its decision making, if it does not perform these activities itself.

6.64. When funding is provided to a party for the development of an intangible, the relevant decisions relating to taking on, laying off or declining a risk bearing opportunity and the decisions on whether and how to respond

5. Further guidance will be provided on the economically relevant characteristics for determining the arm's length conditions for financial transactions, including when the funding is used for project finance, in particular investments in the development of intangibles. This work will be undertaken in 2016 and 2017.

to the risks associated with the opportunity, are the decisions related to the provision of funding and the conditions of the transaction. Depending on the facts and circumstances, such decisions may depend on an assessment of the creditworthiness of the party receiving the funds and an assessment of how the risks related to the development project may impact the expectations in relation to the returns on funding provided or additional funding required. The conditions underlying the provision of the funding may include the possibility to link funding decisions to key development decisions which will impact the funding return. For example, decisions may have to be made on whether to take the project to the next stage or to allow the investments in costly assets. The higher the development risk and the closer the financial risk is related to the development risk, the more the funder will need to have the capability to assess the progress of the development of the intangible and the consequences of this progress for achieving its expected funding return, and the more closely the funder may link the continued provision of funding to key operational developments that may impact its financial risk. The funder will need to have the capability to make the assessments regarding the continued provision of funding, and will need to actually make such assessments, which will then need to be taken into account by the funder in actually making the relevant decisions on the provision of funding.

B.2.3. Assumption of risks

6.65. Particular types of risk that may have importance in a functional analysis relating to transactions involving intangibles include (i) risks related to development of intangibles, including the risk that costly research and development or marketing activities will prove to be unsuccessful, and taking into account the timing of the investment (for example, whether the investment is made at an early stage, mid-way through the development process, or at a late stage will impact the level of the underlying investment risk); (ii) the risk of product obsolescence, including the possibility that technological advances of competitors will adversely affect the value of the intangibles; (iii) infringement risk, including the risk that defence of intangible rights or defence against other persons' claims of infringement may prove to be time consuming, costly and/or unavailing; (iv) product liability and similar risks related to products and services based on the intangibles; and (v) exploitation risks, uncertainties in relation to the returns to be generated by the intangible. The existence and level of such risks will depend on the facts and circumstances of each individual case and the nature of the intangible in question.

6.66. The identity of the member or members of the group assuming risks related to the development, enhancement, maintenance, protection, and exploitation of intangibles is an important consideration in determining prices for controlled transactions. The assumption of risk will determine which entity or entities will be responsible for the consequences if the risk

materialises. The accurate delineation of the controlled transaction, based on the guidance in Section D.1 of Chapter I, may determine that the legal owner assumes risks or that, instead, other members of the group are assuming risks, and such members must be compensated for their contributions in that regard.

6.67. In determining which member or members of the group assume risks related to intangibles, the principles of Section D.1.2 of Chapter I apply. In particular, steps 1 to 5 of the process to analyse risk in a controlled transaction as laid out in paragraph 1.60 should be followed in determining which party assumes risks related to the development, enhancement, maintenance, protection, and exploitation of intangibles.

6.68. It is especially important to ensure that the group member(s) asserting entitlement to returns from assuming risk actually bear responsibility for the actions that need to be taken and the costs that may be incurred if the relevant risk materialises. If costs are borne or actions are undertaken by an associated enterprise other than the associated enterprise assuming the risk as determined under the framework for analysing risk reflected in paragraph 1.60 of these guidelines, then a transfer pricing adjustment should be made so that the costs are allocated to the party assuming the risk and the other associated enterprise is appropriately remunerated for any activities undertaken in connection with the materialisation of the risk. Example 7 in Annex I to Chapter VI illustrates this principle.

B.2.4. Actual, ex post returns

6.69. It is quite common that actual (*ex post*) profitability is different than anticipated (*ex ante*) profitability. This may result from risks materialising in a different way to what was anticipated through the occurrence of unforeseeable developments. For example, it may happen that a competitive product is removed from the market, a natural disaster takes place in a key market, a key asset malfunctions for unforeseeable reasons, or that a breakthrough technological development by a competitor will have the effect of making products based on the intangible in question obsolete or less desirable. It may also happen that the financial projections, on which calculations of *ex ante* returns and compensation arrangements are based, properly took into account risks and the probability of reasonably foreseeable events occurring and that the differences between actual and anticipated profitability reflects the playing out of those risks. Finally, it may happen that financial projections, on which calculations of *ex ante* returns and compensation arrangements are based, did not adequately take into account the risks of different outcomes occurring and therefore led to an overestimation or an underestimation of the anticipated profits. The question arises in such circumstances whether, and if so, how the profits or losses should be shared among members of an MNE group that have

contributed to the development, enhancement, maintenance, protection, and exploitation of the intangible in question.

6.70. Resolution of this question requires a careful analysis of which entity or entities in the MNE group in fact assume the economically significant risks as identified when delineating the actual transaction (see Section D.1 of Chapter I). As this analytical framework indicates, the party actually assuming the economically significant risks may or may not be the associated enterprise contractually assuming these risks, such as the legal owner of the intangible, or may or may not be the funder of the investment. A party which is not allocated the risks that give rise to the deviation between the anticipated and actual outcomes under the principles of Sections D.1.2.1.4 to D.1.2.1.6 of Chapter I will not be entitled to the differences between actual and anticipated profits or required to bear losses that are caused by these differences if such risk materialises, unless these parties are performing the important functions as reflected in paragraph 6.56 or contributing to the control over the economically significant risks as established in paragraph 1.105, and it is determined that arm's length remuneration of these functions would include a profit sharing element. In addition, consideration must be given to whether the *ex ante* remuneration paid to members of the MNE group for their functions performed, assets used, and risks assumed is, in fact, consistent with the arm's length principle. Care should be taken to ascertain, for example, whether the group in fact underestimated or overestimated anticipated profits, thereby giving rise to underpayments or overpayments (determined on an *ex ante* basis) to some group members for their contributions. Transactions for which valuation is highly uncertain at the time of the transaction are particularly susceptible to such under or overestimations of value. This is further discussed in Section D.4.

B.2.5. Some implications from applying Sections B.1 and B.2

6.71. If the legal owner of an intangible in substance:

- performs and controls all of the functions (including the important functions described in paragraph 6.56) related to the development, enhancement, maintenance, protection and exploitation of the intangible;
- provides all assets, including funding, necessary to the development, enhancement, maintenance, protection, and exploitation of the intangibles; and
- assumes all of the risks related to the development, enhancement, maintenance, protection, and exploitation of the intangible,

then it will be entitled to all of the anticipated, *ex ante*, returns derived from the MNE group's exploitation of the intangible. To the extent that one or more members of the MNE group other than the legal owner

performs functions, uses assets, or assumes risks related to the development, enhancement, maintenance, protection and exploitation of the intangible, such associated enterprises must be compensated on an arm's length basis for their contributions. This compensation may, depending on the facts and circumstances, constitute all or a substantial part of the return anticipated to be derived from the exploitation of the intangible.

6.72. The entitlement of any member of the MNE group to profit or loss relating to differences between actual (*ex post*) and a proper estimation of anticipated (*ex ante*) profitability will depend on which entity or entities in the MNE group in fact assumes the risks as identified when delineating the actual transaction (see Section D.1 of Chapter I). It will also depend on the entity or entities which are performing the important functions as reflected in paragraph 6.56 or contributing to the control over the economically significant risks as established in paragraph 1.105, and for which it is determined that an arm's length remuneration of these functions would include a profit sharing element.

B.3. Identifying and determining the prices and other conditions for the controlled transactions

6.73. Undertaking the analysis described in Section D.1 of Chapter I, as supplemented by this Chapter, should facilitate a clear assessment of legal ownership, functions, assets and risks associated with intangibles, and an accurate identification of the transactions whose prices and other conditions require determination. In general, the transactions identified by the MNE group in the relevant registrations and contracts are those whose prices and other conditions are to be determined under the arm's length principle. However, the analysis may reveal that transactions in addition to, or different from, the transactions described in the registrations and contracts actually occurred. Consistent with Section D.1 of Chapter I, the transactions (and the true terms thereof) to be analysed are those determined to have occurred consistent with the actual conduct of the parties and other relevant facts.

6.74. Arm's length prices and other conditions for transactions should be determined according to the guidance in Chapters I-III, taking into account the contributions to anticipated intangible value of functions performed, assets used, and risks assumed at the time such functions are performed, assets are used, or risks are assumed as discussed in this Section B of this chapter. Section D of this chapter provides supplemental guidance on transfer pricing methods and other matters applicable in determining arm's length prices and other conditions for transactions involving intangibles.

B.4. Application of the foregoing principles in specific fact patterns

6.75. The principles set out in this Section B must be applied in a variety of situations involving the development, enhancement, maintenance, protection, and exploitation of intangibles. A key consideration in each case is that associated enterprises that contribute to the development, enhancement, maintenance, protection, or exploitation of intangibles legally owned by another member of the group must receive arm's length compensation for the functions they perform, the risks they assume, and the assets they use. In evaluating whether associated enterprises that perform functions or assume risks related to the development, enhancement, maintenance, protection, and exploitation of intangibles have been compensated on an arm's length basis, it is necessary to consider (i) the level and nature of the activity undertaken; and (ii) the amount and form of compensation paid. In assessing whether the compensation provided in the controlled transaction is consistent with the arm's length principle, reference should be made to the level and nature of activity of comparable uncontrolled entities performing similar functions, the compensation received by comparable uncontrolled entities performing similar functions, and the anticipated creation of intangible value by comparable uncontrolled entities performing similar functions. This section describes the application of these principles in commonly occurring fact patterns.

B.4.1. Development and enhancement of marketing intangibles

6.76. A common situation where these principles must be applied arises when an enterprise associated with the legal owner of trademarks performs marketing or sales functions that benefit the legal owner of the trademark, for example through a marketing arrangement or through a distribution/marketing arrangement. In such cases, it is necessary to determine how the marketer or distributor should be compensated for its activities. One important issue is whether the marketer/distributor should be compensated only for providing promotion and distribution services, or whether the marketer/distributor should also be compensated for enhancing the value of the trademarks and other marketing intangibles by virtue of its functions performed, assets used, and risks assumed.

6.77. The analysis of this issue requires an assessment of (i) the obligations and rights implied by the legal registrations and agreements between the parties; (ii) the functions performed, the assets used, and the risks assumed by the parties; (iii) the intangible value anticipated to be created through the marketer/distributor's activities; and (iv) the compensation provided for the functions performed by the marketer/distributor (taking account of the assets used and risks assumed). One relatively clear case is where a distributor acts merely as an agent, being reimbursed for its promotional expenditures and being directed and controlled in its activities by the owner of the trademarks

and other marketing intangibles. In that case, the distributor ordinarily would be entitled to compensation appropriate to its agency activities alone. It does not assume the risks associated with the further development of the trademark and other marketing intangibles, and would therefore not be entitled to additional remuneration in that regard.

6.78. When the distributor actually bears the cost of its marketing activities (for example, when there is no arrangement for the legal owner to reimburse the expenditures), the analysis should focus on the extent to which the distributor is able to share in the potential benefits deriving from its functions performed, assets used, and risks assumed currently or in the future. In general, in arm's length transactions the ability of a party that is not the legal owner of trademarks and other marketing intangibles to obtain the benefits of marketing activities that enhance the value of those intangibles will depend principally on the substance of the rights of that party. For example, a distributor may have the ability to obtain benefits from its functions performed, assets used, and risks assumed in developing the value of a trademark and other marketing intangibles from its turnover and market share when it has a long-term contract providing for sole distribution rights for the trademarked product. In such a situation the distributor's efforts may have enhanced the value of its own intangibles, namely its distribution rights. In such cases, the distributor's share of benefits should be determined based on what an independent distributor would receive in comparable circumstances. In some cases, a distributor may perform functions, use assets or assume risks that exceed those an independent distributor with similar rights might incur or perform for the benefit of its own distribution activities and that create value beyond that created by other similarly situated marketers/distributors. An independent distributor in such a case would typically require additional remuneration from the owner of the trademark or other intangibles. Such remuneration could take the form of higher distribution profits (resulting from a decrease in the purchase price of the product), a reduction in royalty rate, or a share of the profits associated with the enhanced value of the trademark or other marketing intangibles, in order to compensate the distributor for its functions, assets, risks, and anticipated value creation. Examples 8 to 13 in Annex I to Chapter VI illustrate in greater detail the application of this Section B in the context of marketing and distribution arrangements.

B.4.2. Research, development and process improvement arrangements

6.79. The principles set out in the foregoing paragraphs also apply in situations involving the performance of research and development functions by a member of an MNE group under a contractual arrangement with an associated enterprise that is the legal owner of any resulting intangibles.

Appropriate compensation for research services will depend on all the facts and circumstances, such as whether the research team possesses unique skills and experience relevant to the research, assumes risks (e.g. where “blue sky” research is undertaken), uses its own intangibles, or is controlled and managed by another party. Compensation based on a reimbursement of costs plus a modest mark-up will not reflect the anticipated value of, or the arm’s length price for, the contributions of the research team in all cases.

6.80. The principles set out in this section similarly apply in situations where a member of an MNE group provides manufacturing services that may lead to process or product improvements on behalf of an associated enterprise that will assume legal ownership of such process or product improvements. Examples 14 to 17 in Annex I to Chapter VI illustrate in greater detail the application of this Section B in the context of research and development arrangements.

B.4.3. Payments for use of the company name

6.81. Questions often arise regarding the arm’s length compensation for the use of group names, trade names and similar intangibles. Resolution of such questions should be based on the principles of this Section B and on the commercial and legal factors involved. As a general rule, no payment should be recognised for transfer pricing purposes for simple recognition of group membership or the use of the group name merely to reflect the fact of group membership. See paragraph 7.12

6.82. Where one member of the group is the owner of a trademark or other intangible for the group name, and where use of the name provides a financial benefit to members of the group other than the member legally owning such intangible, it is reasonable to conclude that a payment for use would have been made in arm’s length transactions. Similarly, such payments may be appropriate where a group member owns goodwill in respect of the business represented by an unregistered trademark, use of that trademark by another party would constitute misrepresentation, and the use of the trademark provides a clear financial benefit to a group member other than that owning the goodwill and unregistered trademark.

6.83. In determining the amount of payment with respect to a group name, it is important to consider the amount of the financial benefit to the user of the name attributable to use of that name, the costs and benefits associated with other alternatives, and the relative contributions to the value of the name made by the legal owner, and the entity using the name in the form of functions performed, assets used and risks assumed. Careful consideration should be given to the functions performed, assets used, and risks assumed by the user of the name in creating or enhancing the value of the name in

its jurisdiction. Factors that would be important in a licence of the name to an independent enterprise under comparable circumstances applying the principles of Chapters I-III should be taken into account.

6.84. Where an existing successful business is acquired by another successful business and the acquired business begins to use a name, trademark or other branding indicative of the acquiring business, there should be no automatic assumption that a payment should be made in respect of such use. If there is a reasonable expectation of financial benefit to the acquired company from using the acquiring company's branding, then the amount of any payment should be informed by the level of that anticipated benefit.

6.85. It may also be the case that the acquiring business will leverage the existing position of the acquired business to expand the business of the acquirer in the territory of operation of the acquired business by causing the acquired business to use the acquirer's branding. In that case, consideration should be given to whether the acquirer should make a payment to or otherwise compensate the acquired business for the functions performed, risks assumed, and assets used (including its market position) in connection with expanded use of the acquirer's name.

C. Transactions involving the use or transfer of intangibles

6.86. In addition to identifying with specificity the intangibles involved in a particular transfer pricing issue, and identifying the owner of such intangibles, it is necessary to identify and properly characterise, at the beginning of any transfer pricing analysis involving intangibles, the specific controlled transactions involving intangibles. The principles of Chapter I apply in identifying and accurately delineating transactions involving the use or transfer of intangibles. In addition to the guidance on identifying the actual transaction (Section D.1 of Chapter I) and on business restructurings (Chapter IX, especially Part I), Section C of this chapter outlines some typical scenarios that may be useful in ascertaining whether intangibles or rights in intangibles are involved in a transaction. See Example 19. The characterisation of a transaction for transfer pricing purposes has no relevance for determinations under Article 12 of the OECD Model Tax Convention. See, e.g. paragraphs 8 to 19 of the Commentary to Article 12 of the OECD Model Tax Convention.

6.87. There are two general types of transactions where the identification and examination of intangibles will be relevant for transfer pricing purposes. These are: (i) transactions involving transfers of intangibles or rights in intangibles; and (ii) transactions involving the use of intangibles in connection with the sale of goods or the provision of services.

C.1. Transactions involving transfers of intangibles or rights in intangibles

C.1.1. Transfers of intangibles or rights in intangibles

6.88. Rights in intangibles themselves may be transferred in controlled transactions. Such transactions may involve a transfer of all rights in the intangibles in question (e.g. a sale of the intangible or a perpetual, exclusive licence of the intangible) or only limited rights (e.g. a licence or similar transfer of limited rights to use an intangible which may be subject to geographical restrictions, limited duration, or restrictions with respect to the right to use, exploit, reproduce, further transfer or further develop). The principles of Chapters I-III apply to transactions involving the transfer of intangibles or rights in intangibles. Supplemental guidance regarding the determination of arm's length conditions for such transactions is also contained in Sections D.1, D.2 and D.3 of this chapter.

6.89. In transactions involving the transfer of intangibles or rights in intangibles, it is essential to identify with specificity the nature of the intangibles and rights in intangibles that are transferred between associated enterprises. Where limitations are imposed on the rights transferred, it is also essential to identify the nature of such limitations and the full extent of the rights transferred. It should be noted in this regard that the labels applied to transactions do not control the transfer pricing analysis. For example, in the case of a transfer of the exclusive right to exploit a patent in Country X, the taxpayer's decision to characterise the transaction either as a sale of all of the Country X patent rights, or as a perpetual exclusive licence of a portion of the worldwide patent rights, does not affect the determination of the arm's length price if, in either case, the transaction being priced is a transfer of exclusive rights to exploit the patent in Country X over its remaining useful life. Thus, the functional analysis should identify the nature of the transferred rights in intangibles with specificity.

6.90. Restrictions imposed in licence and similar agreements on the use of an intangible in the further development of new intangibles or new products using the intangibles are often of significant importance in a transfer pricing analysis. It is therefore important in identifying the nature of a transfer of rights in intangibles to consider whether the transferee receives the right to use the transferred intangible for the purpose of further research and development. In transactions between independent enterprises, arrangements are observed where the transferor/licensor retains the full right to any enhancements of the licensed intangible that may be developed during the term of the licence. Transactions between independent enterprises are also observed where the transferee/licensee retains the right to any enhancements it may develop, either for the term of its licence or in perpetuity. The nature of any limitations on further development of transferred intangibles, or on

the ability of the transferee and the transferor to derive an economic benefit from such enhancements, can affect the value of the rights transferred and the comparability of two transactions involving otherwise identical or closely comparable intangibles. Such limitations must be evaluated in light of both the written terms of agreements and the actual conduct of the affected parties.

6.91. The provisions of Section D.1.1 of Chapter I apply in identifying the specific nature of a transaction involving a transfer of intangibles or rights in intangibles, in identifying the nature of any intangibles transferred, and in identifying any limitations imposed by the terms of the transfer on the use of those intangibles. For example, a written specification that a licence is non-exclusive or of limited duration need not be respected by the tax administration if such specification is not consistent with the conduct of the parties. Example 18 in Annex I to Chapter VI illustrates the provisions of this paragraph.

C.1.2. Transfers of combinations of intangibles

6.92. Intangibles (including limited rights in intangibles) may be transferred individually or in combination with other intangibles. In considering transactions involving transfers of combinations of intangibles, two related issues often arise.

6.93. The first of these involves the nature and economic consequences of interactions between different intangibles. It may be the case that some intangibles are more valuable in combination with other intangibles than would be the case if the intangibles were considered separately. It is therefore important to identify the nature of the legal and economic interactions between intangibles that are transferred in combination.

6.94. For example, a pharmaceutical product will often have associated with it three or more types of intangibles. The active pharmaceutical ingredient may be protected by one or more patents. The product will also have been through a testing process and a government regulatory authority may have issued an approval to market the product in a given geographic market and for specific approved indications based on that testing. The product may be marketed under a particular trademark. In combination these intangibles may be extremely valuable. In isolation, one or more of them may have much less value. For example, the trademark without the patent and regulatory marketing approval may have limited value since the product could not be sold without the marketing approval and generic competitors could not be excluded from the market without the patent. Similarly, the value of the patent may be much greater once regulatory marketing approval has been obtained than would be the case in the absence of the marketing approval. The interactions between each of these classes of intangibles, as well as which parties performed functions, bore the risks and incurred the costs associated with securing

the intangibles, are therefore very important in performing a transfer pricing analysis with regard to a transfer of the intangibles. It is important to consider the relative contribution to value creation where different associated enterprises hold rights in the intangibles used.

6.95. A second and related issue involves the importance of ensuring that all intangibles transferred in a particular transaction have been identified. It may be the case, for example, that intangibles are so intertwined that it is not possible, as a substantive matter, to transfer one without transferring the other. Indeed, it will often be the case that a transfer of one intangible will necessarily imply the transfer of other intangibles. In such cases it is important to identify all of the intangibles made available to the transferee as a consequence of an intangibles transfer, applying the principles of Section D.1 of Chapter I. For example, the transfer of rights to use a trademark under a licence agreement will usually also imply the licensing of the reputational value, sometimes referred to as goodwill, associated with that trademark, where it is the licensor who has built up such goodwill. Any licence fee required should consider both the trademark and the associated reputational value. Example 20 in Annex I to Chapter VI illustrates the principles of this paragraph.

6.96. It is important to identify situations where taxpayers or tax administrations may seek to artificially separate intangibles that, as a matter of substance, independent parties would not separate in comparable circumstances. For example, attempts to artificially separate trademarks or trade names from the goodwill or reputational value that is factually associated with the trademark or trade name should be identified and critically analysed. Example 21 in Annex I to Chapter VI illustrates the principles of this paragraph.

6.97. It should be recognised that the process of identifying all of the intangibles transferred in a particular transaction is an exercise of identifying, by reference to written agreements and the actual conduct of the parties, the actual transactions that have been undertaken, applying the principles of Section D.1 of Chapter I.

C.1.3. Transfers of intangibles or rights in intangibles in combination with other business transactions

6.98. In some situations intangibles or rights in intangibles may be transferred in combination with tangible business assets, or in combination with services. It is important in such a situation to determine whether intangibles have in fact been transferred in connection with the transaction. It is also important that all of the intangibles transferred in connection with a particular transaction be identified and taken into account in the transfer pricing analysis. Examples 23 to 25 in Annex I to Chapter VI illustrate the principles of this paragraph.

6.99. In some situations it may be both possible and appropriate to separate transactions in tangible goods or services from transfers of intangibles or rights in intangibles for purposes of conducting a transfer pricing analysis. In these situations, the price of a package contract should be disaggregated in order to confirm that each element of the transaction is consistent with the arm's length principle. In other situations transactions may be so closely related that it will be difficult to segregate tangible goods or service transactions from transfers of intangibles or rights in intangibles. Reliability of available comparables will be an important factor in considering whether transactions should be combined or segregated. In particular, it is important to consider whether available comparables permit accurate evaluation of interactions between transactions.

6.100. One situation where transactions involving transfers of intangibles or rights in intangibles may be combined with other transactions involves a business franchise arrangement. Under such an arrangement, one member of an MNE group may agree to provide a combination of services and intangibles to an associated enterprise in exchange for a single fee. If the services and intangibles made available under such an arrangement are sufficiently unique that reliable comparables cannot be identified for the entire service/intangible package, it may be necessary to segregate the various parts of the package of services and intangibles for separate transfer pricing consideration. It should be kept in mind, however, that the interactions between various intangibles and services may enhance the value of both.

6.101. In other situations, the provision of a service and the transfer of one or more intangibles may be so closely intertwined that it is difficult to separate the transactions for purposes of a transfer pricing analysis. For example, some transfers of rights in software may be combined with an undertaking by the transferor to provide ongoing software maintenance services, which may include periodic updates to the software. In situations where services and transfers of intangibles are intertwined, determining arm's length prices on an aggregate basis may be necessary.

6.102. It should be emphasised that delineating the transaction as the provision of products or services or the transfer of intangibles or a combination of both does not necessarily dictate the use of a particular transfer pricing method. For example, a cost plus approach will not be appropriate for all service transactions, and not all intangibles transactions require complex valuations or the application of profit split methods. The facts of each specific situation, and the results of the required functional analysis, will guide the manner in which transactions are combined, delineated and analysed for transfer pricing purposes, as well as the selection of the most appropriate transfer pricing method in a particular case. The ultimate objective is to identify the prices and other relevant conditions that would be established between independent enterprises in comparable transactions.

6.103. Moreover, it should also be emphasised that determinations as to whether transactions should be aggregated or segregated for analysis usually involve the delineation of the actual transaction undertaken, by reference to written agreements and the actual conduct of the parties. Determinations regarding the actual transaction undertaken constitute one necessary element in determining the most appropriate transfer pricing method in the particular case.

C.2. Transactions involving the use of intangibles in connection with sales of goods or performance of services

6.104. Intangibles may be used in connection with controlled transactions in situations where there is no transfer of the intangible or of rights in the intangible. For example, intangibles may be used by one or both parties to a controlled transaction in connection with the manufacture of goods sold to an associated enterprise, in connection with the marketing of goods purchased from an associated enterprise, or in connection with the performance of services on behalf of an associated enterprise. The nature of such a transaction should be clearly specified, and any relevant intangibles used by either of the parties in connection with such a controlled transaction should be identified and taken into account in the comparability analysis, in the selection and application of the most appropriate transfer pricing method for that transaction, and in the choice of the tested party. Supplemental guidance regarding the determination of arm's length conditions for transactions involving the use of intangibles in connection with the sale of goods or the provision of services is contained in Sections D.1 and D.4 of this chapter.

6.105. The need to consider the use of intangibles by a party to a controlled transaction involving a sale of goods can be illustrated as follows. Assume that a car manufacturer uses valuable proprietary patents to manufacture the cars that it then sells to associated distributors. Assume that the patents significantly contribute to the value of the cars. The patents and the value they contribute should be identified and taken into account in the comparability analysis of the transaction consisting in the sales of cars by the car manufacturer to its associated distributors, in selecting the most appropriate transfer pricing method for the transactions, and in selecting the tested party. The associated distributors purchasing the cars do not, however, acquire any right in the manufacturer's patents. In such a case, the patents are used in the manufacturing and may affect the value of the cars, but the patents themselves are not transferred.

6.106. As another example of the use of intangibles in connection with a controlled transaction, assume that an exploration company has acquired or developed valuable geological data and analysis, and sophisticated exploratory software and know-how. Assume further that it uses those intangibles in

providing exploration services to an associated enterprise. Those intangibles should be identified and taken into account in the comparability analysis of the service transactions between the exploration company and the associated enterprise, in selecting the most appropriate transfer pricing method for the transaction, and in selecting the tested party. Assuming that the associated enterprise of the exploration company does not acquire any rights in the exploration company's intangibles, the intangibles are used in the performance of the services and may affect the value of services, but are not transferred.

D. Supplemental guidance for determining arm's length conditions in cases involving intangibles

6.107. After identifying the relevant transactions involving intangibles, specifically identifying the intangibles involved in those transactions, identifying which entity or entities legally own the intangibles as well as those that contribute to the value of the intangibles, it should be possible to identify arm's length conditions for the relevant transactions. The principles set out in Chapters I-III of these Guidelines should be applied in determining arm's length conditions for transactions involving intangibles. In particular, the recommended nine-step process set out in paragraph 3.4 can be helpful in identifying arm's length conditions for transactions involving intangibles. As an essential part of applying the principles of Chapter III to conduct a comparability analysis under the process described in paragraph 3.4, the principles contained in Sections A, B, and C of this Chapter VI should be considered.

6.108. However, the principles of Chapters I-III can sometimes be difficult to apply to controlled transactions involving intangibles. Intangibles may have special characteristics that complicate the search for comparables, and in some cases make pricing difficult to determine at the time of the transaction. Further, for wholly legitimate business reasons, due to the relationship between them, associated enterprises might sometimes structure a transaction involving intangibles in a manner that independent enterprises would not contemplate. See paragraph 1.11. The use or transfer of intangibles may raise challenging issues regarding comparability, selection of transfer pricing methods, and determination of arm's length conditions for transactions. This Section D provides supplemental guidance for use in applying the principles of Chapters I-III to determine arm's length conditions for controlled transactions involving intangibles.

6.109. Section D.1 provides general supplemental guidance related to all transactions involving intangibles. Section D.2 provides supplemental guidance specifically related to transactions involving the transfer of intangibles or rights in intangibles. Section D.3 provides supplemental guidance regarding transfers of intangibles or rights in intangibles whose value is highly uncertain at the time of the transfer. Section D.4 provides an approach to pricing

hard-to-value intangibles. Section D.5 provides supplemental guidance applicable to transactions involving the use of intangibles in connection with the sale of goods or the provision of services in situations where there is no transfer of rights in the intangibles.

D.1. General principles applicable in transactions involving intangibles

6.110. Section D of Chapter I and Chapter III contain principles to be considered and a recommended process to be followed in conducting a comparability analysis. The principles described in those sections of the Guidelines apply to all controlled transactions involving intangibles.

6.111. In applying the principles of the Guidelines related to the content and process of a comparability analysis to a transaction involving intangibles, a transfer pricing analysis must consider the options realistically available to each of the parties to the transaction.

6.112. In considering the options realistically available to the parties, the perspectives of each of the parties to the transaction must be considered. A comparability analysis focusing only on one side of a transaction generally does not provide a sufficient basis for evaluating a transaction involving intangibles (including in those situations for which a one-sided transfer pricing method is ultimately determined).

6.113. While it is important to consider the perspectives of both parties to the transaction in conducting a comparability analysis, the specific business circumstances of one of the parties should not be used to dictate an outcome contrary to the realistically available options of the other party. For example, a transferor would not be expected to accept a price for the transfer of either all or part of its rights in an intangible that is less advantageous to the transferor than its other realistically available options (including making no transfer at all), merely because a particular associated enterprise transferee lacks the resources to effectively exploit the transferred rights in the intangible. Similarly, a transferee should not be expected to accept a price for a transfer of rights in one or more intangibles that would make it impossible for the transferee to anticipate earning a profit using the acquired rights in the intangible in its business. Such an outcome would be less favourable to the transferee than its realistically available option of not engaging in the transfer at all.

6.114. It will often be the case that a price for a transaction involving intangibles can be identified that is consistent with the realistically available options of each of the parties. The existence of such prices is consistent with the assumption that MNE groups seek to optimise resource allocations. If situations arise in which the minimum price acceptable to the transferor, based on its realistically available options, exceeds the maximum price

acceptable to the transferee, based on its realistically available options, it may be necessary to consider whether the actual transaction should be disregarded under the criterion for non-recognition set out in Section D.2 of Chapter I, or whether the conditions of the transaction should otherwise be adjusted. Similarly, if situations arise in which there are assertions that either the current use of an intangible, or a proposed realistically available option (i.e. an alternative use of the intangible), does not optimise resource allocations, it may be necessary to consider whether such assertions are consistent with the true facts and circumstances of the case. This discussion highlights the importance of taking all relevant facts and circumstances into account in accurately delineating the actual transaction involving intangibles.

D.2. Supplemental guidance regarding transfers of intangibles or rights in intangibles

6.115. This section provides supplemental guidance regarding specific issues arising in connection with the transfer between associated enterprises of intangibles or rights in intangibles. Such transactions may include sales of intangibles as well as transactions that are economically equivalent to sales. Such transactions could also include a licence of rights in one or more intangibles or a similar transaction. This section is not intended to provide comprehensive guidance with regard to the transfer pricing treatment of such intangibles transfers. Rather, it supplements the otherwise applicable provisions of Chapters I-III, and the guidance in Sections A, B, C, and D.1 of this chapter, in the context of transfers of intangibles or rights in intangibles, by providing guidance with regard to certain specific topics commonly arising in connection with such transfers.

D.2.1. Comparability of intangibles or rights in intangibles

6.116. In applying the provisions of Chapters I-III to transactions involving the transfer of intangibles or rights in intangibles, it should be borne in mind that intangibles often have unique characteristics, and as a result have the potential for generating returns and creating future benefits that could differ widely. In conducting a comparability analysis with regard to a transfer of intangibles, it is therefore essential to consider the unique features of the intangibles. This is particularly important where the CUP method is considered to be the most appropriate transfer pricing method, but also has importance in applying other methods that rely on comparables. In the case of a transfer of an intangible or rights in an intangible that provides the enterprise with a unique competitive advantage in the market, purportedly comparable intangibles or transactions should be carefully scrutinised. It is critical to assess whether potential comparables in fact exhibit similar profit potential.

6.117. Set out below is a description of some of the specific features of intangibles that may prove important in a comparability analysis involving transfers of intangibles or rights in intangibles. The following list is not exhaustive and in a specific case consideration of additional or different factors may be an essential part of a comparability analysis.

D.2.1.1. Exclusivity

6.118. Whether the rights in intangibles relevant to a particular transaction involving the transfer of intangibles or rights in intangibles are exclusive or non-exclusive can be an important comparability consideration. Some intangibles allow the legal owner of the intangible to exclude others from using the intangible. A patent, for example, grants an exclusive right to use the invention covered by the patent for a period of years. If the party controlling intangible rights can exclude other enterprises from the market, or exclude them from using intangibles that provide a market advantage, that party may enjoy a high degree of market power or market influence. A party with non-exclusive rights to intangibles will not be able to exclude all competitors and will generally not have the same degree of market power or influence. Accordingly, the exclusive or non-exclusive nature of intangibles or rights in intangibles should be considered in connection with the comparability analysis.

D.2.1.2. Extent and duration of legal protection

6.119. The extent and duration of legal protection of the intangibles relevant to a particular transfer can be an important comparability consideration. Legal protections associated with some intangibles can prevent competitors from entering a particular market. For other intangibles, such as know-how or trade secrets, available legal protections may have a different nature and not be as strong or last as long. For intangibles with limited useful lives, the duration of legal protections can be important since the duration of the intangible rights will affect the expectation of the parties to a transaction with regard to the future benefits from the exploitation of the intangible. For example, two otherwise comparable patents will not have equivalent value if one expires at the end of one year while the other expires only after ten years.

D.2.1.3. Geographic scope

6.120. The geographic scope of the intangibles or rights in intangibles will be an important comparability consideration. A global grant of rights to intangibles may be more valuable than a grant limited to one or a few jurisdictions, depending on the nature of the product, the nature of the intangible, and the nature of the markets in question.

D.2.1.4. Useful life

6.121. Many intangibles have a limited useful life. The useful life of a particular intangible can be affected by the nature and duration of the legal protections afforded to the intangible, as noted above. The useful life of some intangibles can also be affected by the rate of technological change in an industry and by the development of new and potentially improved products. It may also be the case that the useful life of particular intangibles can be extended.

6.122. In conducting a comparability analysis, it will therefore be important to consider the expected useful life of the intangibles in question. In general, intangibles expected to provide market advantages for a longer period of time will be more valuable than similar intangibles providing such advantages for a shorter period of time, other things being equal. In evaluating the useful life of intangibles it is also important to consider the use being made of the intangible. The useful life of an intangible that forms a base for ongoing research and development may extend beyond the commercial life of the current generation product line based on that intangible.

D.2.1.5. Stage of development

6.123. In conducting a comparability analysis, it may be important to consider the stage of development of particular intangibles. It is often the case that an intangible is transferred in a controlled transaction at a point in time before it has been fully demonstrated that the intangible will support commercially viable products. A common example arises in the pharmaceutical industry, where chemical compounds may be patented, and the patents (or rights to use the patents) transferred in controlled transactions, well in advance of the time when further research, development and testing demonstrates that the compound constitutes a safe and effective treatment for a particular medical condition.

6.124. As a general rule, intangibles relating to products with established commercial viability will be more valuable than otherwise comparable intangibles relating to products whose commercial viability is yet to be established. In conducting a comparability analysis involving partially developed intangibles, it is important to evaluate the likelihood that further development will lead to commercially significant future benefits. In certain circumstances, industry data regarding the risks associated with further development can be helpful to such evaluations. However, the specific circumstances of any individual situation should always be considered.

D.2.1.6. Rights to enhancements, revisions, and updates

6.125. Often, an important consideration in a comparability analysis involving intangibles relates to the rights of the parties with regard to future enhancements, revisions and updates of the intangibles. In some industries, products protected

by intangibles can become obsolete or uncompetitive in a relatively short period of time in the absence of continuing development and enhancement of the intangibles. As a result, having access to updates and enhancements can be the difference between deriving a short term advantage from the intangibles and deriving a longer term advantage. It is therefore necessary to consider for comparability purposes whether or not a particular grant of rights in intangibles includes access to enhancements, revisions, and updates of the intangibles.

6.126. A very similar question, often important in a comparability analysis, involves whether the transferee of intangibles obtains the right to use the intangibles in connection with research directed to developing new and enhanced intangibles. For example, the right to use an existing software platform as a basis for developing new software products can shorten development times and can make the difference between being the first to market with a new product or application, or being forced to enter a market already occupied by established competitive products. A comparability analysis with regard to intangibles should, therefore, consider the rights of the parties regarding the use of the intangibles in developing new and enhanced versions of products.

D.2.1.7. Expectation of future benefit

6.127. Each of the foregoing comparability considerations has a consequence with regard to the expectation of the parties to a transaction regarding the future benefits to be derived from the use of the intangibles in question. If for any reason there is a significant discrepancy between the anticipated future benefit of using one intangible as opposed to another, it is difficult to consider the intangibles as being sufficiently comparable to support a comparables-based transfer pricing analysis in the absence of reliable comparability adjustments. Specifically, it is important to consider the actual and potential profitability of products or potential products that are based on the intangible. Intangibles that provide a basis for high profit products or services are not likely to be comparable to intangibles that support products or services with only industry average profits. Any factor materially affecting the expectation of the parties to a controlled transaction of obtaining future benefits from the intangible should be taken into account in conducting the comparability analysis.

D.2.2. Comparison of risk in cases involving transfers of intangibles or rights in intangibles

6.128. In conducting a comparability analysis involving the transfer of intangibles or rights in intangibles, the existence of risks related to the likelihood of obtaining future economic benefits from the transferred intangibles must be considered, including the allocation of risk between the parties which should be analysed within the framework set out in Section D.1.2 of Chapter I. The following types of risks, among others, should be considered in evaluating

whether transfers of intangibles or combinations of intangibles are comparable, and in evaluating whether the intangibles themselves are comparable.

- Risks related to the future development of the intangibles. This includes an evaluation of whether the intangibles relate to commercially viable products, whether the intangibles may support commercially viable products in the future, the expected cost of required future development and testing, the likelihood that such development and testing will prove successful and similar considerations. The consideration of development risk is particularly important in situations involving transfers of partially developed intangibles.
- Risks related to product obsolescence and depreciation in the value of the intangibles. This includes an evaluation of the likelihood that competitors will introduce products or services in the future that would materially erode the market for products dependent on the intangibles being analysed.
- Risks related to infringement of the intangible rights. This includes an evaluation of the likelihood that others might successfully claim that products based on the intangibles infringe their own intangible rights and an evaluation of the likely costs of defending against such claims. It also includes an evaluation of the likelihood that the holder of intangible rights could successfully prevent others from infringing the intangibles, the risk that counterfeit products could erode the profitability of relevant markets, and the likelihood that substantial damages could be collected in the event of infringement.
- Product liability and similar risks related to the future use of the intangibles.

D.2.3. Comparability adjustments with regard to transfers of intangibles or rights in intangibles

6.129. The principles of paragraphs 3.47 to 3.54 relating to comparability adjustments apply with respect to transactions involving the transfer of intangibles or rights in intangibles. It is important to note that differences between intangibles can have significant economic consequences that may be difficult to adjust for in a reliable manner. Particularly in situations where amounts attributable to comparability adjustments represent a large percentage of the compensation for the intangible, there may be reason to believe, depending on the specific facts, that the computation of the adjustment is not reliable and that the intangibles being compared are in fact not sufficiently comparable to support a valid transfer pricing analysis. If reliable comparability adjustments are not possible, it may be necessary to select a transfer pricing method that is less dependent on the identification of comparable intangibles or comparable transactions.

D.2.4. Use of comparables drawn from databases

6.130. Comparability, and the possibility of making comparability adjustments, is especially important in considering potentially comparable intangibles and related royalty rates drawn from commercial databases or proprietary compilations of publicly available licence or similar agreements. The principles of Section A.4.3.1 of Chapter III apply fully in assessing the usefulness of transactions drawn from such sources. In particular, it is important to assess whether publicly available data drawn from commercial databases and proprietary compilations is sufficiently detailed to permit an evaluation of the specific features of intangibles that may be important in conducting a comparability analysis. In evaluating comparable licence arrangements identified from databases, the specific facts of the case, including the methodology being applied, should be considered in the context of the provisions of paragraph 3.38.

D.2.5. Selecting the most appropriate transfer pricing method in a matter involving the transfer of intangibles or rights in intangibles

6.131. The principles of these Guidelines related to the selection of the most appropriate transfer pricing method to the circumstances of the case are described in paragraphs 2.1 to 2.12. Those principles apply fully to cases involving the transfer of intangibles or rights in intangibles. In selecting the most appropriate transfer pricing method in a case involving a transfer of intangibles or rights in intangibles, attention should be given to (i) the nature of the relevant intangibles, (ii) the difficulty of identifying comparable uncontrolled transactions and intangibles in many, if not most, cases, and (iii) the difficulty of applying certain of the transfer pricing methods described in Chapter II in cases involving the transfer of intangibles. The issues discussed below are particularly important in the selection of transfer pricing methods under the Guidelines.

6.132. In applying the principles of paragraphs 2.1 to 2.12 to matters involving the transfer of intangibles or rights in intangibles, it is important to recognise that transactions structured in different ways may have similar economic consequences. For example, the performance of a service using intangibles may have very similar economic consequences to a transaction involving the transfer of an intangible (or the transfer of rights in the intangible), as either may convey the value of the intangible to the transferee. Accordingly, in selecting the most appropriate transfer pricing method in connection with a transaction involving the transfer of intangibles or rights in intangibles, it is important to consider the economic consequences of the transaction, rather than proceeding on the basis of an arbitrary label.

6.133. This chapter makes it clear that in matters involving the transfer of intangibles or rights in intangibles it is important not to simply assume that all residual profit, after a limited return to those providing functions, should necessarily be allocated to the owner of intangibles. The selection of the most appropriate transfer pricing method should be based on a functional analysis that provides a clear understanding of the MNE's global business processes and how the transferred intangibles interact with other functions, assets and risks that comprise the global business. The functional analysis should identify all factors that contribute to value creation, which may include risks borne, specific market characteristics, location, business strategies, and MNE group synergies among others. The transfer pricing method selected, and any adjustments incorporated in that method based on the comparability analysis, should take into account all of the relevant factors materially contributing to the creation of value, not only intangibles and routine functions.

6.134. The principles set out in paragraphs 2.12, 3.58 and 3.59 regarding the use of more than one transfer pricing method apply to matters involving the transfer of intangibles or rights in intangibles.

6.135. Paragraphs 3.9 to 3.12 and paragraph 3.37 provide guidance regarding the aggregation of separate transactions for purposes of transfer pricing analysis. Those principles apply fully to cases involving the transfer of intangibles or rights in intangibles and are supplemented by the guidance in Section C of this chapter. Indeed, it is often the case that intangibles may be transferred in combination with other intangibles, or in combination with transactions involving the sale of goods or the performance of services. In such situations it may well be that the most reliable transfer pricing analysis will consider the interrelated transactions in the aggregate as necessary to improve the reliability of the analysis.

D.2.6. Supplemental guidance on transfer pricing methods in matters involving the transfer of intangibles or rights in intangibles

6.136. Depending on the specific facts, any of the five OECD transfer pricing methods described in Chapter II might constitute the most appropriate transfer pricing method to the circumstances of the case where the transaction involves a controlled transfer of one or more intangibles. The use of other alternatives may also be appropriate.

6.137. Where the comparability analysis identifies reliable information related to comparable uncontrolled transactions, the determination of arm's length prices for a transfer of intangibles or rights in intangibles can be determined on the basis of such comparables after making any comparability adjustments that may be appropriate and reliable.

6.138. However, it will often be the case in matters involving transfers of intangibles or rights in intangibles that the comparability analysis (including

the functional analysis) reveals that there are no reliable comparable uncontrolled transactions that can be used to determine the arm's length price and other conditions. This can occur if the intangibles in question have unique characteristics, or if they are of such critical importance that such intangibles are transferred only among associated enterprises. It may also result from a lack of available data regarding potentially comparable transactions or from other causes. Notwithstanding the lack of reliable comparables, it is usually possible to determine the arm's length price and other conditions for the controlled transaction.

6.139. Where information regarding reliable comparable uncontrolled transactions cannot be identified, the arm's length principle requires use of another method to determine the price that uncontrolled parties would have agreed under comparable circumstances. In making such determinations, it is important to consider:

- The functions, assets and risks of the respective parties to the transaction.
- The business reasons for engaging in the transaction.
- The perspectives of and options realistically available to each of the parties to the transaction.
- The competitive advantages conferred by the intangibles including especially the relative profitability of products and services or potential products and services related to the intangibles.
- The expected future economic benefits from the transaction.
- Other comparability factors such as features of local markets, location savings, assembled workforce, and MNE group synergies.

6.140. In identifying prices and other conditions that would have been agreed between independent enterprises under comparable circumstances, it is often essential to carefully identify idiosyncratic aspects of the controlled transaction that arise by virtue of the relationship between the parties. There is no requirement that associated enterprises structure their transactions in precisely the same manner as independent enterprises might have done. However, where transactional structures are utilised by associated enterprises that are not typical of transactions between independent parties, the effect of those structures on prices and other conditions that would have been agreed between uncontrolled parties under comparable circumstances should be taken into account in evaluating the profits that would have accrued to each of the parties at arm's length.

6.141. Care should be used, in applying certain of the OECD transfer pricing methods in a matter involving the transfer of intangibles or rights in intangibles. One sided methods, including the resale price method and the

TNMM, are generally not reliable methods for directly valuing intangibles. In some circumstances such mechanisms can be utilised to indirectly value intangibles by determining values for some functions using those methods and deriving a residual value for intangibles. However, the principles of paragraph 6.133 are important when following such approaches and care should be exercised to ensure that all functions, risks, assets and other factors contributing to the generation of income are properly identified and evaluated.

6.142. The use of transfer pricing methods that seek to estimate the value of intangibles based on the cost of intangible development is generally discouraged. There rarely is any correlation between the cost of developing intangibles and their value or transfer price once developed. Hence, transfer pricing methods based on the cost of intangible development should usually be avoided.

6.143. However, in some limited circumstances, transfer pricing methods based on the estimated cost of reproducing or replacing the intangible may be utilised. Such approaches may sometimes have valid application with regard to the development of intangibles used for internal business operations (e.g. internal software systems), particularly where the intangibles in question are not unique and valuable intangibles. Where intangibles relating to products sold in the marketplace are at issue, however, replacement cost valuation methods raise serious comparability issues. Among other concerns, it is necessary to evaluate the effect of time delays associated with deferred development on the value of the intangibles. Often, there may be a significant first mover advantage in having a product on the market at an early date. As a result, an identical product (and the supporting intangibles) developed in future periods will not be as valuable as the same product (and the supporting intangibles) available currently. In such a case, the estimated replacement cost will not be a valid proxy for the value of an intangible transferred currently. Similarly, where an intangible carries legal protections or exclusivity characteristics, the value of being able to exclude competitors from using the intangible will not be reflected in an analysis based on replacement cost. Cost based valuations generally are not reliable when applied to determine the arm's length price for partially developed intangibles.

6.144. The provisions of paragraph 2.10 related to the use of rules of thumb apply to determinations of a correct transfer price in any controlled transaction, including cases involving the use or transfer of intangibles. Accordingly, a rule of thumb cannot be used to evidence that a price or apportionment of income is arm's length, including in particular an apportionment of income between a licensor and a licensee of intangibles.

6.145. The transfer pricing methods most likely to prove useful in matters involving transfers of one or more intangibles are the CUP method and the transactional profit split method. Valuation techniques can be useful tools.

Supplemental guidance on the transfer pricing methods most likely to be useful in connection with transfers of intangibles is provided below.

D.2.6.1. Application of the CUP Method

6.146. Where reliable comparable uncontrolled transactions can be identified, the CUP method can be applied to determine the arm's length conditions for a transfer of intangibles or rights in intangibles. The general principles contained in paragraphs 2.14 to 2.26 apply when the CUP method is used in connection with transactions involving the transfer of intangibles. Where the CUP method is utilised in connection with the transfer of intangibles, particular consideration must be given to the comparability of the intangibles or rights in intangibles transferred in the controlled transaction and in the potential comparable uncontrolled transactions. The economically relevant characteristics or comparability factors described in Section D.1 of Chapter I should be considered. The matters described in Sections D.2.1 to D.2.4 of this chapter are of particular importance in evaluating the comparability of specific transferred intangibles and in making comparability adjustments, where possible. It should be recognised that the identification of reliable comparables in many cases involving intangibles may be difficult or impossible.

6.147. In some situations, intangibles acquired by an MNE group from independent enterprises are transferred to a member of the MNE group in a controlled transaction immediately following the acquisition. In such a case the price paid for the acquired intangibles will often (after any appropriate adjustments, including adjustments for acquired assets not re-transferred) represent a useful comparable for determining the arm's length price for the controlled transaction under a CUP method. Depending on the facts and circumstances, the third party acquisition price in such situations will have relevance in determining arm's length prices and other conditions for the controlled transaction, even where the intangibles are acquired indirectly through an acquisition of shares or where the price paid to the third party for shares or assets exceeds the book value of the acquired assets. Examples 23 and 26 in Annex I to Chapter VI illustrate the principles of this paragraph.

D.2.6.2. Application of transactional profit split method

6.148. In some circumstances, a transactional profit split method can be utilised to determine the arm's length conditions for a transfer of intangibles or rights in intangibles where it is not possible to identify reliable comparable uncontrolled transactions for such transfers. Section C of Chapter II contains guidance to be considered in applying transactional profit split methods. That guidance is fully applicable to matters involving the transfer of intangibles or rights in intangibles. In evaluating the reliability of transactional profit split

methods, however, the availability of reliable and adequate data regarding the relevant profits to be split, appropriately allocable expenses, and the reliability of factors used to divide the relevant income should be fully considered.

6.149. Transactional profit split methods may have application in connection with the sale of full rights in intangibles. As with other applications of the transactional profit split method, a full functional analysis that considers the functions performed, risks assumed and assets used by each of the parties is an essential element of the analysis. Where a transactional profit split analysis is based on projected revenues and expenses, the concerns with the accuracy of such projections described in Section D.2.6.4.1 should be taken into account.

6.150. It is also sometimes suggested that a profit split analysis can be applied to transfers of partially developed intangibles. In such an analysis, the relative value of contributions to the development of intangibles before and after a transfer of the intangibles in question is sometimes examined. Such an approach may include an attempt to amortise the transferor's contribution to the partially developed intangible over the asserted useful life of that contribution, assuming no further development. Such approaches are generally based on projections of cash flows and benefits expected to arise at some future date following the transfer and the assumed successful completion of further development activities.

6.151. Caution should be exercised in applying profit split approaches to determine estimates of the contributions of the parties to the creation of income in years following the transfer, or an arm's length allocation of future income, with respect to partially developed intangibles. The contribution or value of work undertaken prior to the transfer may bear no relationship to the cost of that work. For example, a chemical compound with potentially blockbuster pharmaceutical indications might be developed in the laboratory at relatively little cost. In addition, a variety of difficult to evaluate factors would need to be taken into account in such a profit split analysis. These would include the relative riskiness and value of research contributions before and after the transfer, the relative risk and its effect on value, for other development activities carried out before and after the transfer, the appropriate amortisation rate for various contributions to the intangible value, assumptions regarding the time at which any potential new products might be introduced, and the value of contributions other than intangibles to the ultimate generation of profit. Income and cash flow projections in such situations can sometimes be especially speculative. These factors can combine to call the reliability of such an application of a profit split analysis into question. See Section D.4 on hard-to-value intangibles.

6.152. Where limited rights in fully developed intangibles are transferred in a licence or similar transaction, and reliable comparable uncontrolled transactions cannot be identified, a transactional profit split method can often be utilised to evaluate the respective contributions of the parties to earning

the relevant income. The profit contribution of the rights in intangibles made available by the licensor or other transferor would, in such a circumstance, be one of the factors contributing to the earning of income following the transfer. However, other factors would also need to be considered. In particular, functions performed and risks assumed by the licensee/transferee should specifically be taken into account in such an analysis. Other intangibles used by the licensor/transferor and by the licensee/transferee in their respective businesses should similarly be considered, as well as other relevant factors. Careful attention should be given in such an analysis to the limitations imposed by the terms of the transfer on the use of the intangibles by the licensee/transferee and on the rights of the licensee/transferee to use the intangibles for purposes of ongoing research and development. Further, assessing contributions of the licensee to enhancements in the value of licensed intangibles may be important. The allocation of income in such an analysis would depend on the findings of the functional analysis, including an analysis of the relevant risks assumed. It should not be assumed that all of the residual profit after functional returns would necessarily be allocated to the licensor/transferor in a profit split analysis related to a licensing arrangement.

D.2.6.3. Use of valuation techniques

6.153. In situations where reliable comparable uncontrolled transactions for a transfer of one or more intangibles cannot be identified, it may also be possible to use valuation techniques to estimate the arm's length price for intangibles transferred between associated enterprises. In particular, the application of income based valuation techniques, especially valuation techniques premised on the calculation of the discounted value of projected future income streams or cash flows derived from the exploitation of the intangible being valued, may be particularly useful when properly applied. Depending on the facts and circumstances, valuation techniques may be used by taxpayers and tax administrations as a part of one of the five OECD transfer pricing methods described in Chapter II, or as a tool that can be usefully applied in identifying an arm's length price.

6.154. Where valuation techniques are utilised in a transfer pricing analysis involving the transfer of intangibles or rights in intangibles, it is necessary to apply such techniques in a manner that is consistent with the arm's length principle and the principles of these Guidelines. In particular, due regard should be given to the principles contained in Chapters I-III. Principles related to realistically available options, economically relevant characteristics including assumption of risk (see Section D.1 of Chapter I) and aggregation of transactions (see paragraphs 3.9 to 3.12) apply fully to situations where valuation techniques are utilised in a transfer pricing analysis. Furthermore, the rules of these Guidelines on selection of transfer pricing methods apply in determining when such techniques should be used (see paragraphs 2.1 to

2.12). The principles of Sections A, B, C, and D.1 of this chapter also apply where use of valuation techniques is considered.

6.155. It is essential to consider the assumptions and other motivations that underlie particular applications of valuation techniques. For sound accounting purposes, some valuation assumptions may sometimes reflect conservative assumptions and estimates of the value of assets reflected in a company's balance sheet. This inherent conservatism can lead to definitions that are too narrow for transfer pricing purposes and valuation approaches that are not necessarily consistent with the arm's length principle. Caution should therefore be exercised in accepting valuations performed for accounting purposes as necessarily reflecting arm's length prices or values for transfer pricing purposes without a thorough examination of the underlying assumptions. In particular, valuations of intangibles contained in purchase price allocations performed for accounting purposes are not determinative for transfer pricing purposes and should be utilised in a transfer pricing analysis with caution and careful consideration of the underlying assumptions.

6.156. It is not the intention of these Guidelines to set out a comprehensive summary of the valuation techniques utilised by valuation professionals. Similarly, it is not the intention of these Guidelines to endorse or reject one or more sets of valuation standards utilised by valuation or accounting professionals or to describe in detail or specifically endorse one or more specific valuation techniques or methods as being especially suitable for use in a transfer pricing analysis. However, where valuation techniques are applied in a manner that gives due regard to these Guidelines, to the specific facts of the case, to sound valuation principles and practices, and with appropriate consideration of the validity of the assumptions underlying the valuation and the consistency of those assumptions with the arm's length principle, such techniques can be useful tools in a transfer pricing analysis where reliable comparable uncontrolled transactions are not available. See, however, paragraphs 6.142 and 6.143 for a discussion of the reliability and application of valuation techniques based on intangible development costs.

6.157. Valuation techniques that estimate the discounted value of projected future cash flows derived from the exploitation of the transferred intangible or intangibles can be particularly useful when properly applied. There are many variations of these valuation techniques. In general terms, such techniques measure the value of an intangible by the estimated value of future cash flows it may generate over its expected remaining lifetime. The value can be calculated by discounting the expected future cash flows to present value.⁶ Under this approach valuation requires, among other things,

6. In the case of a financial valuation based on projections, the analysis will often be based on projections of cash flows. Accrual based measures of income, such

defining realistic and reliable financial projections, growth rates, discount rates, the useful life of intangibles, and the tax effects of the transaction. Moreover it entails consideration of terminal values when appropriate. Depending on the facts and circumstances of the individual case, the calculation of the discounted value of projected cash flows derived from the exploitation of the intangible should be evaluated from the perspectives of both parties to the transaction in arriving at an arm's length price. The arm's length price will fall somewhere within the range of present values evaluated from the perspectives of the transferor and the transferee. Examples 27 to 29 in Annex I to Chapter VI illustrate the provisions of this section.

D.2.6.4. Specific areas of concern in applying methods based on the discounted value of projected cash flows

6.158. When applying valuation techniques, including valuation techniques based on projected cash flows, it is important to recognise that the estimates of value based on such techniques can be volatile. Small changes in one or another of the assumptions underlying the valuation model or in one or more of the valuation parameters can lead to large differences in the intangible value the model produces. A small percentage change in the discount rate, a small percentage change in the growth rates assumed in producing financial projections, or a small change in the assumptions regarding the useful life of the intangible can each have a profound effect on the ultimate valuation. Moreover, this volatility is often compounded when changes are made simultaneously to two or more valuation assumptions or parameters.

6.159. The reliability of the intangible value produced using a valuation model is particularly sensitive to the reliability of the underlying assumptions and estimates on which it is based and on the due diligence and judgment exercised in confirming assumptions and in estimating valuation parameters.

6.160. Because of the importance of the underlying assumptions and valuation parameters, taxpayers and tax administrations making use of valuation techniques in determining arm's length prices for transferred intangibles should explicitly set out each of the relevant assumptions made in

as those determined for accounting or tax purposes, may not properly reflect the timing of cash flows which can create a difference in outcome between an income and a cash flow based approach. However, in light of a number of considerations, the use of income projections rather than cash flow projections may, in some cases, yield a more reliable result in a transfer pricing context as a practical matter. Care must be taken, however, to assure that either income or cash flow measures are applied in a consistent manner and in appropriate circumstances. References to cash flow in this document should therefore be read broadly to include both cash flow and income measures, appropriately applied.

creating the valuation model, should describe the basis for selecting valuation parameters, and should be prepared to defend the reasonableness of such assumptions and valuation parameters. Moreover, it is a good practice for taxpayers relying on valuation techniques to present as part of their transfer pricing documentation some sensitivity analysis reflecting the consequential change in estimated intangible value produced by the model when alternative assumptions and parameters are adopted.

6.161. It may be relevant in assessing the reliability of a valuation model to consider the purposes for which the valuation was undertaken and to examine the assumptions and valuation parameters in different valuations undertaken by the taxpayer for non-tax purposes. It would be reasonable for a tax administration to request an explanation for any inconsistencies in the assumptions made in a valuation of an intangible undertaken for transfer pricing purposes and valuations undertaken for other purposes. For example, such requests would be appropriate if high discount rates are used in a transfer pricing analysis when the company routinely uses lower discount rates in evaluating possible mergers and acquisitions. Such requests would also be appropriate if it is asserted that particular intangibles have short useful lives but the projections used in other business planning contexts demonstrate that related intangibles produce cash flows in years beyond the “useful life” that has been claimed for transfer pricing purposes. Valuations used by an MNE group in making operational business decisions may be more reliable than those prepared exclusively for purposes of a transfer pricing analysis.

6.162. The following sections identify some of the specific concerns that should be taken into account in evaluating certain important assumptions underlying calculations in a valuation model based on discounted cash flows. These concerns are important in evaluating the reliability of the particular application of a valuation technique. Notwithstanding the various concerns expressed above and outlined in detail in the following paragraphs, depending on the circumstances, application of such a valuation technique, either as part of one of the five OECD transfer pricing methods or as a useful tool, may prove to be more reliable than application of any other transfer pricing method, particularly where reliable comparable uncontrolled transactions do not exist.

D.2.6.4.1. Accuracy of financial projections

6.163. The reliability of a valuation of a transferred intangible using discounted cash flow valuation techniques is dependent on the accuracy of the projections of future cash flows or income on which the valuation is based. However, because the accuracy of financial projections is contingent on developments in the marketplace that are both unknown and unknowable at the time the valuation is undertaken, and to this extent such projections are

speculative, it is essential for taxpayers and tax administrations to examine carefully the assumptions underlying the projections of both future revenue and future expense.

6.164. In evaluating financial projections, the source and purpose of the projections can be particularly important. In some cases, taxpayers will regularly prepare financial projections for business planning purposes. It can be that such analyses are used by management of the business in making business and investment decisions. It is usually the case that projections prepared for non-tax business planning purposes are more reliable than projections prepared exclusively for tax purposes, or exclusively for purposes of a transfer pricing analysis.

6.165. The length of time covered by the projections should also be considered in evaluating the reliability of the projections. The further into the future the intangible in question can be expected to produce positive cash flows, the less reliable projections of income and expense are likely to be.

6.166. A further consideration in evaluating the reliability of projections involves whether the intangibles and the products or services to which they relate have an established track record of financial performance. Caution should always be used in assuming that past performance is a reliable guide to the future, as many factors are subject to change. However, past operating results can provide some useful guidance as to likely future performance of products or services that rely on intangibles. Projections with respect to products or services that have not been introduced to the market or that are still in development are inherently less reliable than those with some track record.

6.167. When deciding whether to include development costs in the cash flow projections it is important to consider the nature of the transferred intangible. Some intangibles may have indefinite useful lives and may be continually developed. In these situations it is appropriate to include future development costs in the cash flow forecasts. Others, for example a specific patent, may already be fully developed and, in addition not provide a platform for the development of other intangibles. In these situations no development costs should be included in the cash flow forecasts for the transferred intangible.

6.168. Where, for the foregoing reasons, or any other reason, there is a basis to believe that the projections behind the valuation are unreliable or speculative, attention should be given to the guidance in Section D.3 and D.4.

D.2.6.4.2. Assumptions regarding growth rates

6.169. A key element of some cash flow projections that should be carefully examined is the projected growth rate. Often projections of future cash flows are based on current cash flows (or assumed initial cash flows after product introduction in the case of partially developed intangibles) expanded by reference to a percentage growth rate. Where that is the case, the basis for the assumed growth rate should be considered. In particular, it is unusual for revenues derived from a particular product to grow at a steady rate over a long period of time. Caution should therefore be exercised in too readily accepting simple models containing linear growth rates not justified on the basis of either experience with similar products and markets or a reasonable evaluation of likely future market conditions. It would generally be expected that a reliable application of a valuation technique based on projected future cash flows would examine the likely pattern of revenue and expense growth based on industry and company experience with similar products.

D.2.6.4.3. Discount rates

6.170. The discount rate or rates used in converting a stream of projected cash flows into a present value is a critical element of a valuation model. The discount rate takes into account the time value of money and the risk or uncertainty of the anticipated cash flows. As small variations in selected discount rates can generate large variations in the calculated value of intangibles using these techniques, it is essential for taxpayers and tax administrations to give close attention to the analysis performed and the assumptions made in selecting the discount rate or rates utilised in the valuation model.

6.171. There is no single measure for a discount rate that is appropriate for transfer pricing purposes in all instances. Neither taxpayers nor tax administrations should assume that a discount rate that is based on a Weighted Average Cost of Capital (WACC) approach or any other measure should always be used in transfer pricing analyses where determination of appropriate discount rates is important. Instead the specific conditions and risks associated with the facts of a given case and the particular cash flows in question should be evaluated in determining the appropriate discount rate.

6.172. It should be recognised in determining and evaluating discount rates that in some instances, particularly those associated with the valuation of intangibles still in development, intangibles may be among the most risky components of a taxpayer's business. It should also be recognised that some businesses are inherently more risky than others and some cash flow streams are inherently more volatile than others. For example, the likelihood that a projected level of research and development expense will be incurred may be higher than the likelihood that a projected level of revenues will ultimately

be generated. The discount rate or rates should reflect the level of risk in the overall business and the expected volatility of the various projected cash flows under the circumstances of each individual case.

6.173. Since certain risks can be taken into account either in arriving at financial projections or in calculating the discount rate, care should be taken to avoid double discounting for risk.

D.2.6.4.4. Useful life of intangibles and terminal values

6.174. Valuation techniques are often premised on the projection of cash flows derived from the exploitation of the intangible over the useful life of the intangible in question. In such circumstances, the determination of the actual useful life of the intangible will be one of the critical assumptions supporting the valuation model.

6.175. The projected useful life of particular intangibles is a question to be determined on the basis of all of the relevant facts and circumstances. The useful life of a particular intangible can be affected by the nature and duration of the legal protections afforded the intangible. The useful life of intangibles also may be affected by the rate of technological change in the industry, and by other factors affecting competition in the relevant economic environment. See paragraphs 6.121 and 6.122.

6.176. In some circumstances, particular intangibles may contribute to the generation of cash flow in years after the legal protections have expired or the products to which they specifically relate have ceased to be marketed. This can be the case in situations where one generation of intangibles forms the base for the development of future generations of intangibles and new products. It may well be that some portion of continuing cash flows from projected new products should properly be attributed to otherwise expired intangibles where such follow on effects exist. It should be recognised that, while some intangibles have an indeterminate useful life at the time of valuation, that fact does not imply that non-routine returns are attributable to such intangibles in perpetuity.

6.177. In this regard, where specific intangibles contribute to continuing cash flows beyond the period for which reasonable financial projections exist, it will sometimes be the case that a terminal value for the intangible related cash flows is calculated. Where terminal values are used in valuation calculations, the assumptions underlying their calculation should be clearly set out and the underlying assumptions thoroughly examined, particularly the assumed growth rates.

D.2.6.4.5. Assumptions regarding taxes

6.178. Where the purpose of the valuation technique is to isolate the projected cash flows associated with an intangible, it may be necessary to evaluate and quantify the effect of projected future income taxes on the projected cash flows. Tax effects to be considered include: (i) taxes projected to be imposed on future cash flows, (ii) tax amortisation benefits projected to be available to the transferee, if any, and (iii) taxes projected to be imposed on the transferor as a result of the transfer, if any.

D.2.7. *Form of payment*

6.179. Taxpayers have substantial discretion in defining the form of payment for transferred intangibles. In transactions between independent parties, it is common to observe payments for intangibles that take the form of a single lump sum. It is also common to observe payments for intangibles that take the form of periodic payments over time. Arrangements involving periodic payments can be structured either as a series of instalment payments fixed in amount, or may take the form of contingent payments where the amount of payments depends on the level of sales of products supported by the intangibles, on profitability, or on some other factor. The principles of Section D.1.1 of Chapter I should be followed in evaluating taxpayer agreements with regard to the form of payment.

6.180. In evaluating the provisions of taxpayer agreements related to the form of payment, it should be noted that some payment forms will entail greater or lesser levels of risk to one of the parties. For example, a payment form contingent on future sales or profit will normally involve greater risk to the transferor than a payment form calling for either a single lump-sum payment at the time of the transfer or a series of fixed instalment payments, because of the existence of the contingency. The chosen form of the payment must be consistent with the facts and circumstances of the case, including the written contracts, the actual conduct of the parties, and the ability of the parties to bear and manage the relevant payment risks. In particular, the amount of the specified payments should reflect the relevant time value of money and risk features of the chosen form of payment. For example, if a valuation technique is applied and results in the calculation of a lump-sum present value for the transferred intangible, and if a taxpayer applies a payment form contingent on future sales, the discount rate used in converting the lump-sum valuation to a stream of contingent payments over the useful life of the intangible should reflect the increased risk to the transferor that sales may not materialise and that payments would therefore not be forthcoming, as well as the time value of money consequences arising from the deferral of the payments to future years.

D.3. Arm’s length pricing of transactions involving intangibles for which valuation is highly uncertain at the time of the transaction

6.181. Intangibles or rights in intangibles may have specific features complicating the search for comparables and in some cases making it difficult to determine the value of an intangible at the time of the transaction. When valuation of an intangible or rights in an intangible at the time of the transaction is highly uncertain, the question arises as to how arm’s length pricing should be determined. The question should be resolved, both by taxpayers and tax administrations, by reference to what independent enterprises would have done in comparable circumstances to take account of the valuation uncertainty in the pricing of the transaction. To this aim, the guidance and recommended process in Section D of Chapter I and the principles in Chapter III as supplemented by the guidance in this chapter for conducting a comparability analysis are relevant.

6.182. Depending on the facts and circumstances, there is a variety of mechanisms that independent enterprises might adopt to address high uncertainty in the valuation of the intangible at the time of the transaction. For example, one possibility is to use anticipated benefits (taking into account all relevant economic factors) as a means for establishing the pricing at the outset of the transaction. In determining the anticipated benefits, independent enterprises would take into account the extent to which subsequent developments are foreseeable and predictable. In some cases, independent enterprises might find that subsequent developments are sufficiently predictable and therefore the projections of anticipated benefits are sufficiently reliable to fix the pricing for the transaction at the outset on the basis of those projections.

6.183. In other cases, independent enterprises might find that pricing based on anticipated benefits alone does not provide adequate protection against the risks posed by the high uncertainty in valuing the intangible. In such cases independent enterprises might, for instance, adopt shorter-term agreements, include price adjustment clauses in the terms of the agreement, or adopt a payment structure involving contingent payments to protect against subsequent developments that might not be sufficiently predictable. For these purposes, a contingent pricing arrangement is any pricing arrangement in which the quantum or timing of payments is dependent on contingent events, including the achievement of predetermined financial thresholds such as sales or profits, or of predetermined development stages (e.g. royalty or periodic milestone payments). For example, a royalty rate could be set to increase as the sales of the licensee increase, or additional payments could be required at such time as certain development targets are successfully achieved. For a transfer of intangibles or rights in intangibles at a stage when they are not ready to be commercialised but require further development, payment terms adopted by independent parties on initial transfer might include the

determination of additional contingent amounts that would become payable only on the achievement of specified milestone stages in their further development.

6.184. Also, independent enterprises may determine to assume the risk of unpredictable subsequent developments. However, the occurrence of major events or developments unforeseen by the parties at the time of the transaction or the occurrence of foreseen events or developments considered to have a low probability of occurrence which change the fundamental assumptions upon which the pricing was determined may lead to renegotiation of the pricing arrangements by agreement of the parties where it is to their mutual benefit. For example, a renegotiation might occur at arm's length if a royalty rate based on sales for a patented drug turned out to be vastly excessive due to an unexpected development of an alternative low-cost treatment. The excessive royalty might remove the incentive of the licensee to manufacture or sell the drug at all, in which case the licensee will have an interest in renegotiating the agreement. It may be the case that the licensor has an interest in keeping the drug on the market and in retaining the same licensee to manufacture or sell the drug because of the skills and expertise of the licensee or the existence of a long-standing co-operative relationship between them. Under these circumstances, the parties might prospectively renegotiate to their mutual benefit all or part of the agreement and set a lower royalty rate. In any event, whether renegotiation would take place, would depend upon all the facts and circumstances of each case.

6.185. If independent enterprises in comparable circumstances would have agreed on the inclusion of a mechanism to address high uncertainty in valuing the intangible (e.g. a price adjustment clause), the tax administration should be permitted to determine the pricing of a transaction involving an intangible or rights in an intangible on the basis of such mechanism. Similarly, if independent enterprises in comparable circumstances would have considered subsequent events so fundamental that their occurrence would have led to a prospective renegotiation of the pricing of a transaction, such events should also lead to a modification of the pricing of the transaction between associated enterprises.

D.4. Hard-to-value intangibles (HTVI)

6.186. A tax administration may find it difficult to establish or verify what developments or events might be considered relevant for the pricing of a transaction involving the transfer of intangibles or rights in intangibles, and the extent to which the occurrence of such developments or events, or the direction they take, might have been foreseen or reasonably foreseeable at the time the transaction was entered into. The developments or events that might be of relevance for the valuation of an intangible are in most cases

strongly connected to the business environment in which that intangible is developed or exploited. Therefore, the assessment of which developments or events are relevant and whether the occurrence and direction of such developments or events might have been foreseen or reasonably foreseeable requires specialised knowledge, expertise and insight into the business environment in which the intangible is developed or exploited. In addition, the assessments that are prudent to undertake when evaluating the transfer of intangibles or rights in intangibles in an uncontrolled transaction, may not be seen as necessary or useful for other than transfer pricing purposes by the MNE group when a transfer takes place within the group, with the result that those assessments may not be comprehensive. For example, an enterprise may transfer intangibles at an early stage of development to an associated enterprise, set a royalty rate that does not reflect the value of the intangible at the time of the transfer, and later take the position that it was not possible at the time of the transfer to predict the subsequent success of the product with full certainty. The difference between the *ex ante* and *ex post* value of the intangible would therefore be claimed by the taxpayer to be attributable to more favourable developments than anticipated. The general experience of tax administrations in these situations is that they may not have the specific business insights or access to the information to be able to examine the taxpayer's claim and to demonstrate that the difference between the *ex ante* and *ex post* value of the intangible is due to non-arm's length pricing assumptions made by the taxpayer. Instead, tax administrations seeking to examine the taxpayer's claim are largely dependent on the insights and information provided by that taxpayer. These situations associated with information asymmetry between taxpayers and tax administrations can give rise to transfer pricing risk. See paragraph 6.191.

6.187. In these situations involving the transfer of an intangible or rights in an intangible *ex post* outcomes can provide a pointer to tax administrations about the arm's length nature of the *ex ante* pricing arrangement agreed upon by the associated enterprises, and the existence of uncertainties at the time of the transaction. If there are differences between the *ex ante* projections and the *ex post* results which are not due to unforeseeable developments or events, the differences may give an indication that the pricing arrangement agreed upon by the associated enterprises at the time the transaction was entered into may not have adequately taken into account the relevant developments or events that might have been expected to affect the value of the intangible and the pricing arrangements adopted.

6.188. In response to the considerations discussed above, this section contains an approach consistent with the arm's length principle that tax administrations can adopt to ensure that tax administrations can determine in which situations the pricing arrangements as set by the taxpayers are at arm's length and are based on an appropriate weighting of the foreseeable

developments or events that are relevant for the valuation of certain hard-to-value intangibles, and in which situations this is not the case. Under this approach, *ex post* evidence provides presumptive evidence as to the existence of uncertainties at the time of the transaction, whether the taxpayer appropriately took into account reasonably foreseeable developments or events at the time of the transaction, and the reliability of the information used *ex ante* in determining the transfer price for the transfer of such intangibles or rights in intangibles. Such presumptive evidence may be subject to rebuttal as stated in paragraphs 6.193 and 6.194, if it can be demonstrated that it does not affect the accurate determination of the arm's length price. This situation should be distinguished from the situation in which hindsight is used by taking *ex post* results for tax assessment purposes without considering whether the information on which the *ex post* results are based could or should reasonably have been known and considered by the associated enterprises at the time the transaction was entered into.

6.189. The term hard-to-value intangibles (HTVI) covers intangibles or rights in intangibles for which, at the time of their transfer between associated enterprises, (i) no reliable comparables exist, and (ii) at the time the transactions was entered into, the 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, making it difficult to predict the level of ultimate success of the intangible at the time of the transfer.

6.190. Transactions involving the transfer or the use of HTVI in paragraph 6.189 may exhibit one or more of the following features:

- The intangible is only partially developed at the time of the transfer.
- The intangible is not expected to be exploited commercially until several years following the transaction.
- The intangible does not itself fall within the definition of HTVI in paragraph 6.189 but is integral to the development or enhancement of other intangibles which fall within that definition of HTVI.
- The intangible is expected to be exploited in a manner that is novel at the time of the transfer and the absence of a track record of development or exploitation of similar intangibles makes projections highly uncertain.
- The intangible, meeting the definition of HTVI under paragraph 6.189, has been transferred to an associated enterprise for a lump sum payment.
- The intangible is either used in connection with or developed under a CCA or similar arrangements.

6.191. For such intangibles, information asymmetry between taxpayer and tax administrations, including what information the taxpayer took into account in determining the pricing of the transaction, may be acute and may exacerbate the difficulty encountered by tax administrations in verifying the arm's length basis on which pricing was determined for the reasons discussed in paragraph 6.186. As a result, it will prove difficult for a tax administration to perform a risk assessment for transfer pricing purposes, to evaluate the reliability of the information on which pricing has been based by the taxpayer, or to consider whether the intangible or rights in intangibles have been transferred at undervalue or overvalue compared to the arm's length price, until *ex post* outcomes are known in years subsequent to the transfer.

6.192. In these circumstances, the tax administration can consider *ex post* outcomes as presumptive evidence about the appropriateness of the *ex ante* pricing arrangements. However, the consideration of *ex post* evidence should be based on a determination that such evidence is necessary to be taken into account to assess the reliability of the information on which *ex ante* pricing has been based. Where the tax administration is able to confirm the reliability of the information on which *ex ante* pricing has been based, notwithstanding the approach described in this section, then adjustments based on *ex post* profit levels should not be made. In evaluating the *ex ante* pricing arrangements, the tax administration is entitled to use the *ex post* evidence about financial outcomes to inform the determination of the arm's length pricing arrangements, including any contingent pricing arrangements, that would have been made between independent enterprises at the time of the transaction, considering the guidance in paragraph 6.185. Depending on the facts and circumstances of the case and considering the guidance in Section B.5 of Chapter III, a multi-year analysis of the information for the application of this approach may be appropriate.

6.193. This approach will not apply to transactions involving the transfer or use of HTVI falling within the scope of paragraph 6.189, when at least one of the following exemptions applies:

- i) The taxpayer provides:
 1. Details of the *ex ante* projections used at the time of the transfer to determine the pricing arrangements, including how risks were accounted for in calculations to determine the price (e.g. probability-weighted), and the appropriateness of its consideration of reasonably foreseeable events and other risks, and the probability of occurrence; and,
 2. Reliable evidence that any significant difference between the financial projections and actual outcomes is due to: a) unforeseeable developments or events occurring after the determination of the price that could not have been anticipated by the associated

enterprises at the time of the transaction; or b) the playing out of probability of occurrence of foreseeable outcomes, and that these probabilities were not significantly overestimated or underestimated at the time of the transaction;

- ii) The transfer of the HTVI is covered by a bilateral or multilateral advance pricing arrangement in effect for the period in question between the jurisdictions of the transferee and the transferor.
- iii) Any significant difference between the financial projections and actual outcomes mentioned in i)2 above does not have the effect of reducing or increasing the compensation for the HTVI by more than 20% of the compensation determined at the time of the transaction.
- iv) A commercialisation period of five years has passed following the year in which the HTVI first generated unrelated party revenues for the transferee and in which commercialisation period any significant difference between the financial projections and actual outcomes mentioned in i)2 above was not greater than 20% of the projections for that period.⁷

6.194. The first exemption means that, although the *ex post* evidence about financial outcomes provides relevant information for tax administrations to consider the appropriateness of the *ex ante* pricing arrangements, in circumstances where the taxpayer can satisfactorily demonstrate what was foreseeable at the time of the transaction and reflected in the pricing assumptions, and that the developments leading to the difference between projections and outcomes arose from unforeseeable events, tax administrations will not be entitled to make adjustments to the *ex ante* pricing arrangements based on *ex post* outcomes. For example, if the evidence of financial outcomes shows that sales of products exploiting the transferred intangible reached 1 000 a year, but the *ex ante* pricing arrangements were based on projections that considered sales reaching a maximum of only 100 a year, then the tax administration should consider the reasons for sales reaching such higher volumes. If the higher volumes were due to, for example, an exponentially higher demand for the products incorporating the intangible caused by a natural disaster or some other unexpected event that was clearly unforeseeable at the time of the transaction or appropriately given a very low probability of occurrence, then the *ex ante* pricing should be recognised as being at arm's length, unless there is evidence other than the *ex post* financial outcomes indicating that price setting did not take place on an arm's length basis.

7. In some business sectors it is not unusual for an intangible to be transferred with a contingent clause relating to a second, or further, use. In respect of the type of intangibles where this occurs, the time period begins again with the new commercialisation.

6.195. It would be important to permit resolution of cases of double taxation arising from application of the approach for HTVI through access to the mutual agreement procedure under the applicable Treaty.

D.5. Supplemental guidance for transactions involving the use of intangibles in connection with the sale of goods or the provision of services

6.196. This section provides supplemental guidance for applying the rules of Chapters I-III in situations where one or both parties to a controlled transaction uses intangibles in connection with the sale of goods or the provision of services, but where no transfer of intangibles or interests in intangibles occurs. Where intangibles are present, the transfer pricing analysis must carefully consider the effect of the intangibles involved on the prices and other conditions of controlled transactions.

D.5.1. Intangibles as a comparability factor in transactions involving the use of intangibles

6.197. The general rules of Section D.1 of Chapter I and Chapter III also apply to guide the comparability analysis of transactions involving the use of intangibles in connection with a controlled transaction involving the sale of goods or the provision of services. However, the presence of intangibles may sometimes raise challenging comparability issues.

6.198. In a transfer pricing analysis where the most appropriate transfer pricing method is the resale price method, the cost-plus method, or the transactional net margin method, the less complex of the parties to the controlled transaction is often selected as the tested party. In many cases, an arm's length price or level of profit for the tested party can be determined without the need to value the intangibles used in connection with the transaction. That would generally be the case where only the non-tested party uses intangibles. In some cases, however, the tested party may in fact use intangibles notwithstanding its relatively less complex operations. Similarly, parties to potentially comparable uncontrolled transactions may use intangibles. Where either of these is the case, it becomes necessary to consider the intangibles used by the tested party and by the parties to potentially comparable uncontrolled transactions as one comparability factor in the analysis.

6.199. For example, a tested party engaged in the marketing and distribution of goods purchased in controlled transactions may have developed marketing intangibles in its geographic area of operation, including customer lists, customer relationships, and customer data. It may also have developed advantageous logistical know-how or software and other tools that it uses in conducting its distribution business. The impact of such intangibles on

the profitability of the tested party should be considered in conducting a comparability analysis.

6.200. It is important to note, however, that in many cases where the tested party uses such intangibles, parties to comparable uncontrolled transactions will also have the same types of intangibles at their disposal. Thus, in the distribution company case, an uncontrolled entity engaged in providing distribution services in the tested party's industry and market is also likely to have knowledge of and contacts with potential customers, collect customer data, have its own effective logistical systems, and in other respects have similar intangibles to the tested party. Where that is the case, the level of comparability may be sufficiently high that it is possible to rely on prices paid or margins earned by the potential comparables as an appropriate measure of arm's length compensation for both the functions performed and the intangibles owned by the tested party.

6.201. Where the tested party and the potential comparable have comparable intangibles, the intangibles will not constitute unique and valuable intangibles within the meaning of paragraph 6.17, and therefore no comparability adjustments will be required with regard to the intangibles. The potential comparable will, in these circumstances, provide the best evidence of the profit contribution of the tested party's intangibles. If, however, either the tested party or the potential comparable has and uses in its business unique and valuable intangibles, it may be necessary either to make appropriate comparability adjustments or to revert to a different transfer pricing method. The principles contained in Sections D.2.1 to D.2.4 apply in evaluating the comparability of intangibles in such situations.

6.202. It is appropriate for both taxpayers and tax administrations to exercise restraint in rejecting potential comparables based on the use of intangibles by either the parties to potentially comparable transactions or by the tested party. Potential comparables should generally not be rejected on the basis of the asserted existence of unspecified intangibles or on the basis of the asserted significance of goodwill. If identified transactions or companies are otherwise comparable, they may provide the best available indication of arm's length pricing notwithstanding the existence and use by either the tested party or the parties to the potentially comparable transactions of relatively insignificant intangibles. Potentially comparable transactions should be disregarded on the basis of the existence and use of non-comparable intangibles only where the intangibles in question can be clearly and distinctly identified and where the intangibles are manifestly unique and valuable intangibles.

D.5.2. Determining arm's length prices for transactions involving the use of intangibles in connection with the sale of goods or the performance of services

6.203. The principles of Chapters I-III apply in determining arm's length prices for transactions involving the use of intangibles in connection with sales of goods or the performance of services. Two general categories of cases can arise. In the first category of cases, the comparability analysis, including the functional analysis, will reveal the existence of sufficiently reliable comparables to permit the determination of arm's length conditions for the transaction using a transfer pricing method based on comparables. In the second category of cases, the comparability analysis, including the functional analysis, will fail to identify reliable comparable uncontrolled transactions, often as a direct result of the use by one or both parties to the transaction of unique and valuable intangibles. Transfer pricing approaches to these two categories of cases are described below.

D.5.2.1. Situations where reliable comparables exist

6.204. It will often be the case that, notwithstanding the use of intangibles by one or both parties to a controlled sale of goods or provision of services, reliable comparables can be identified. Depending on the specific facts, any of the five OECD transfer pricing methods described in Chapter II might constitute the most appropriate transfer pricing method where the transaction involves the use of intangibles in connection with a controlled sale of goods or provision of services and reliable comparables are present.

6.205. Where the tested party does not use unique and valuable intangibles, and where reliable comparables can be identified, it will often be possible to determine arm's length prices on the basis of one-sided methods including the CUP, resale price, cost plus and TNMM methods. The guidance in Chapters I-III will generally be sufficient to guide the determination of arm's length prices in such situations, without the need for a detailed analysis of the nature of the intangibles used by the other party to the transaction.

6.206. The principles described in Sections D.2.1 to D.2.4 of this chapter should be applied in determining whether the use of intangibles by the tested party will preclude reliance on identified comparable uncontrolled transactions or require comparability adjustments. Only when the intangibles used by the tested party are unique and valuable intangibles will the need arise to make comparability adjustments or to adopt a transfer pricing method less dependent on comparable uncontrolled transactions. Where intangibles used by the tested party are not unique and valuable intangibles, prices paid or received, or margins or returns earned by parties to comparable uncontrolled transactions may provide a reliable basis for determining arm's length conditions.

6.207. Where the need to make comparability adjustments arises because of differences in the intangibles used by the tested party in a controlled transaction and the intangibles used by a party to a potentially comparable uncontrolled transaction, difficult factual questions can arise in quantifying reliable comparability adjustments. These issues require thorough consideration of the relevant facts and circumstances and of the available data regarding the impact of the intangibles on prices and profits. Where the impact on price of a difference in the nature of the intangibles used is clearly material, but not subject to accurate estimation, it may be necessary to utilise a different transfer pricing method that is less dependent on identification of reliable comparables.

6.208. It should also be recognised that comparability adjustments for factors other than differences in the nature of the intangibles used may be required in matters involving the use of intangibles in connection with a controlled sale of goods or services. In particular, comparability adjustments may be required for matters such as differences in markets, locational advantages, business strategies, assembled workforce, corporate synergies and other similar factors. While such factors may not be intangibles as that term is described in Section A.1 of this chapter, they can nevertheless have important effects on arm's length prices in matters involving the use of intangibles.

D.5.2.2. Situations where reliable comparables do not exist

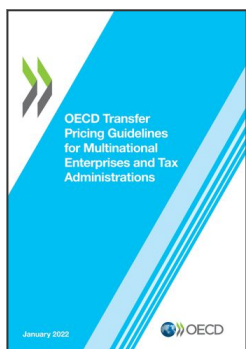
6.209. In some circumstances where reliable uncontrolled transactions cannot be identified, transactional profit split methods may be utilised to determine an arm's length allocation of profits for the sale of goods or the provision of services involving the use of intangibles. One circumstance in which the use of transactional profit split methods may be appropriate is where both parties to the transaction make unique and valuable contributions to the transaction.

6.210. Section C in Part III of Chapter II contains guidance to be considered in applying transactional profit split methods. That guidance is fully applicable to matters involving the use of intangibles in connection with the sale of goods or the provision of services in controlled transactions.

6.211. In applying a profit split method in a case involving the use of intangibles, care should be taken to identify the intangibles in question, to evaluate the manner in which those intangibles contribute to the creation of value, and to evaluate other income producing functions performed, risks assumed and assets used. Vague assertions of the existence and use of unspecified intangibles will not support a reliable application of a profit split method.

6.212. In appropriate circumstances, transfer pricing methods or valuation techniques not dependent on the identification of reliable comparable

uncontrolled transactions may also be utilised to determine arm's length conditions for the sale of goods or the provision of services where intangibles are used in connection with the transaction. The alternative selected should reflect the nature of the goods or services provided and the contribution of intangibles and other relevant factors to the creation of value.



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