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# Assessing Fair Value of IP

## Managing differences in accounting vs. tax valuation analysis

## Client webcast for M&A, accounting and tax

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# With you today

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# Agenda

# The current status of BEPS and the OECD Guidelines on IP

- The OECD's BEPS project is still moving – further OECD deadlines in October 2015
- IP paper has some parts finalised and some parts as interim guidance, but the direction of travel is clear
- Three main areas of focus of the OECD's revised intangibles paper, 'Chapter VI':

1. What is an intangible?
2. What is an appropriate value of/ return for intangibles?
3. Where should returns for intangibles be taxed?

- Both points 2 and 3 are particularly relevant here and are summarised below

# 1) Updated OECD transfer pricing guidance on valuation

- More substantive guidance than in prior drafts on valuation of IP
- Commonly used valuation methods can all be relevant
- Facts and principles led… no specific rules to drive assumptions (e.g. useful life)
- Explicit caution over valuations performed for accounting purposes, and PPA valuations specifically referenced as 'not determinative'
- Specific paper on 'hard to value intangibles'– high evidentiary standard

**In practice**

- The OECD advises a thorough review of the underlying assumptions
- It will often still be possible to match valuations for accounting and tax purposes
- But caution advised, and be prepared for challenge…

# 2) Where should rewards from intangibles be taxed

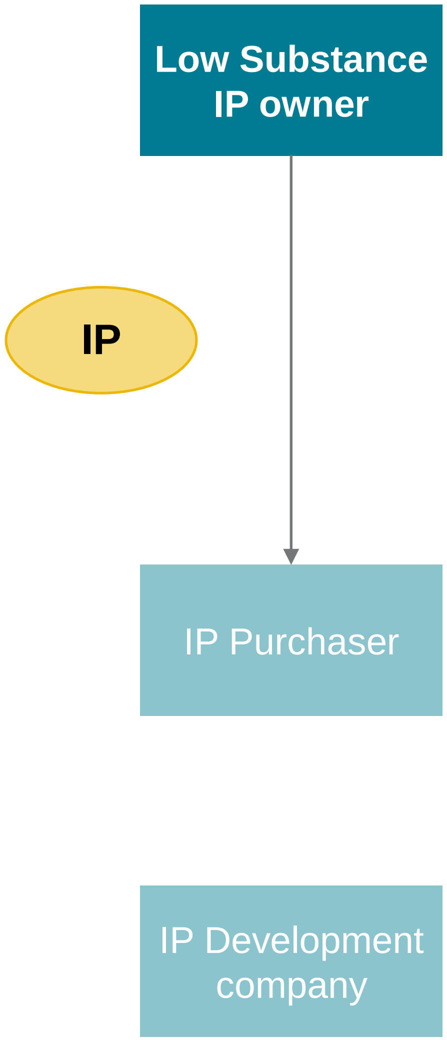
- Three relevant points on the changes to transfer pricing for IP transactions:
  1. Legal ownership of intangibles, by itself, does not confer any right ultimately to retain intangible related returns
  2. Solely funding IP is also not as important for reward…
  3. Instead, rewards to intangibles should flow to entities which have **functional substance** (and perform key risk management activities relating to the IP)

**This means**

- The value of acquired IP to a specific entity will be determined by its level of functional substance
- Acquiring valued IP into a low tax (low substance) entity could no longer be a tax efficient model

# Case 1: Impact of BEPS on IP valuation

- Historically the group has held both the legal and beneficial ownership of its IP in a relatively low substance IP owning company
- The IP owning company has funded all IP development within the group
- For commercial purposes the Group decides to sell its IP intra-group to an entity that is actively involved in the management and development of the IP
- Another entity within the Group has always been involved in the development of the IP and will continue to be involved in the development
- The key tax question is how the IP sales should be valued



# Case 1: Impact of BEPS on IP valuation

**Valuation under current OECD Guidelines**

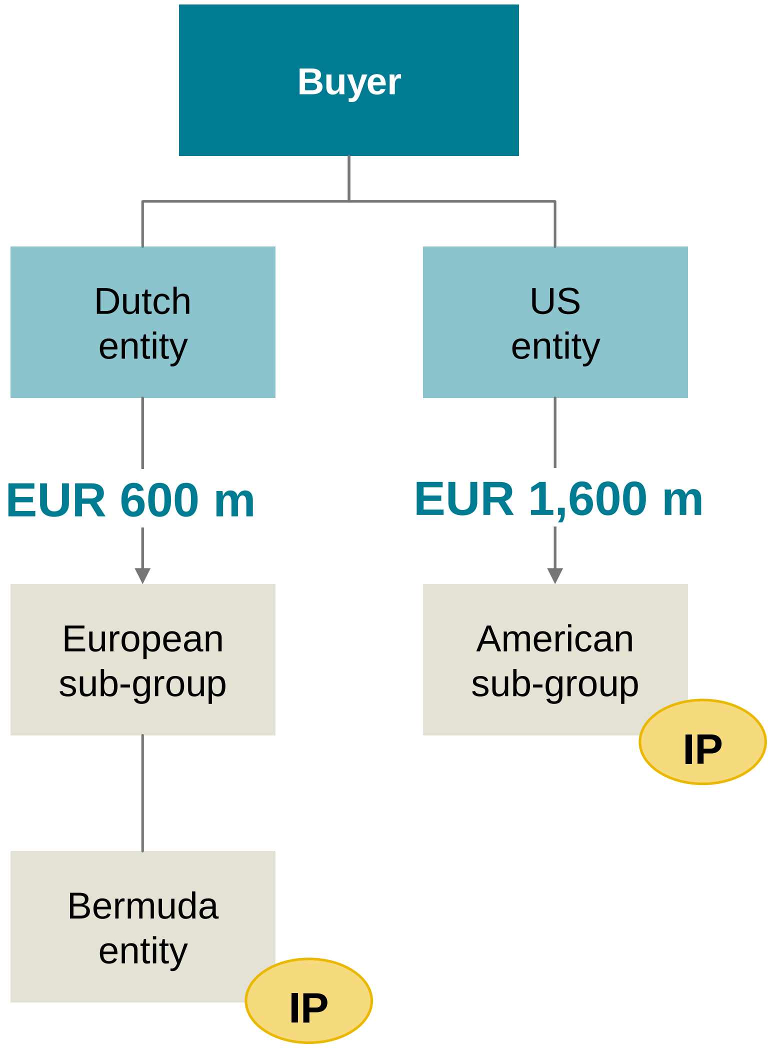
- It would typically be expected that the full value of the IP would be recognized by the IP owning company upon sale
- The IP would be valued under traditional valuation methods such as relief from royalty

**Valuation under BEPS principles**

- Has anything changed? Some fundamental questions to be addressed:
  - Should the amount received by the IP owning company provide it with a return beyond a financing return?
  - Should the IP development company receive any of the proceeds?
  - What is the ongoing transfer pricing?

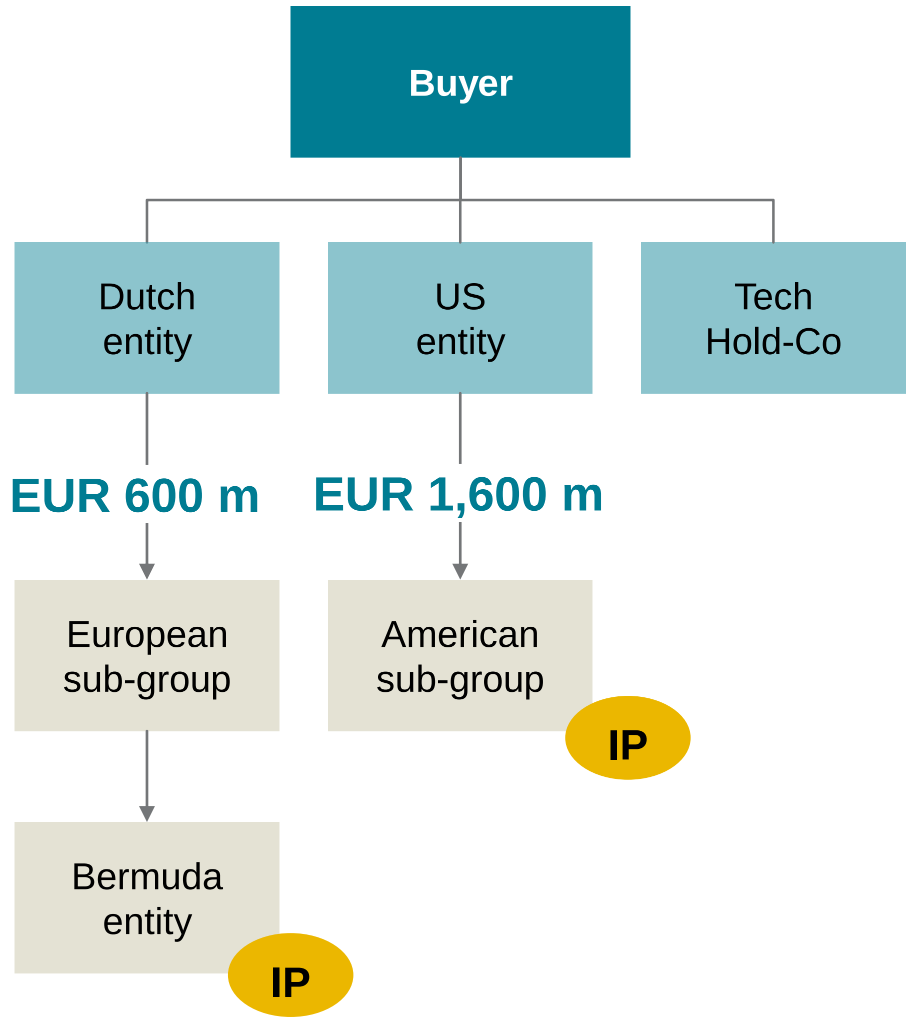
# Case 2: Change in business model and difference in technology value

- Total purchase price of EUR 1.6 billion was allocated to two sub-groups
- The allocation was determined based on current gross profit
- A Bermuda entity and the American entity owned the IP
- Goodwill was determined on the level of the European and the American sub-groups according to IFRS 3 (PPA)



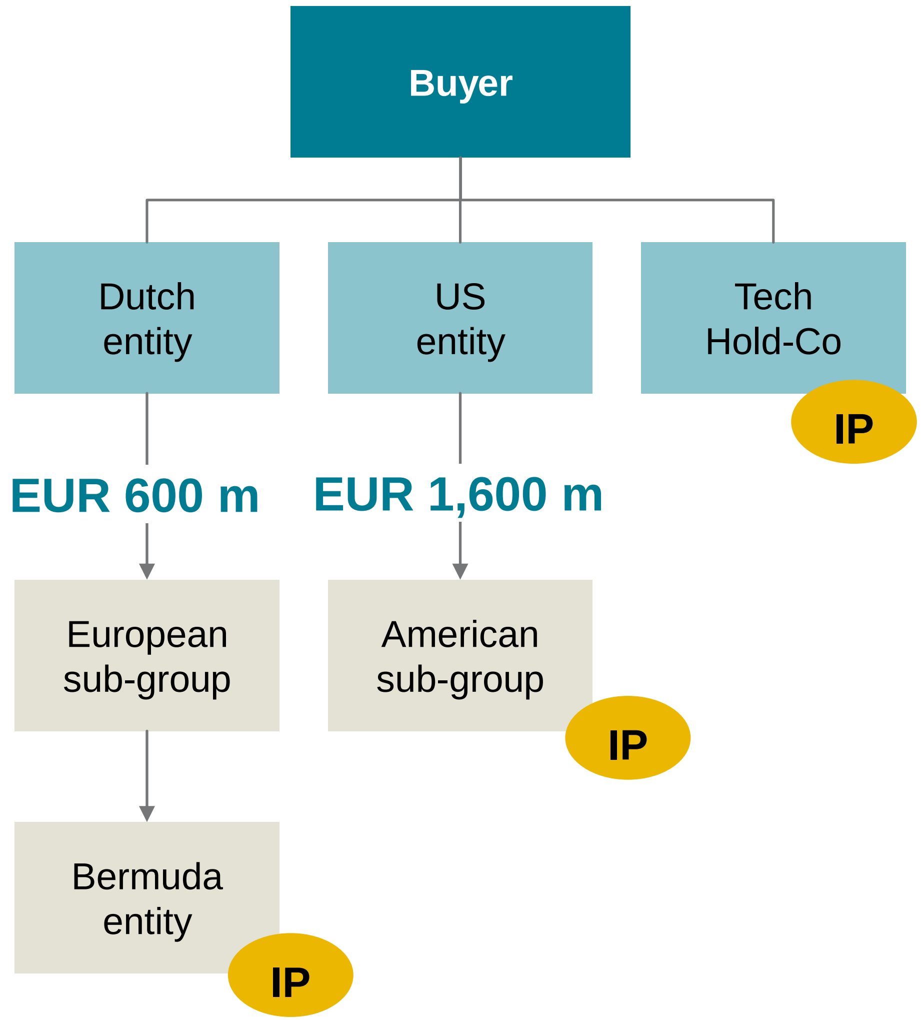
# Case 2: Change in business model and difference in technology value

- Buyer's strategy is to concentrate all IP in a Tech Hold-Co



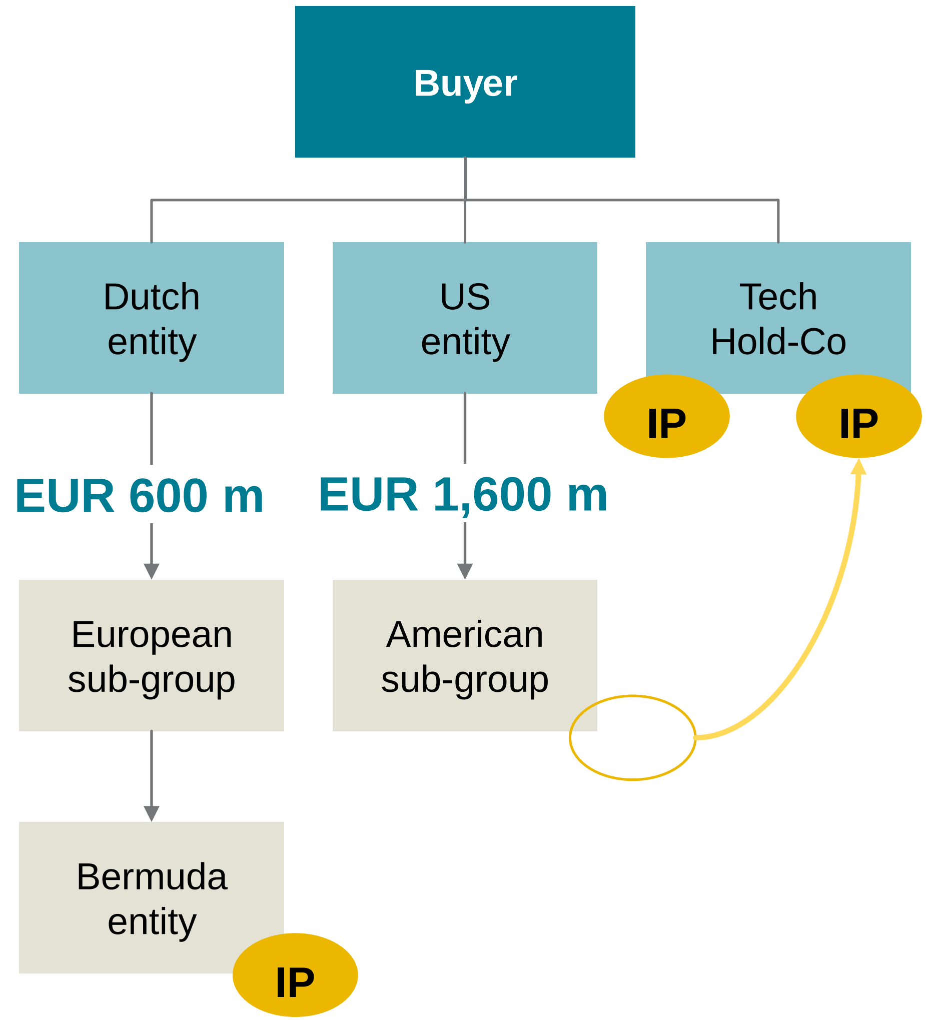
# Case 2: Change in business model and difference in technology value

- Buyer's strategy is to concentrate all IP in a Tech Hold-Co
- The existing technology in Bermuda shall fade out and new technology shall be developed under Tech Hold-Co
  - Change in business model for Bermuda: goodwill write off



# Case 2: Change in business model and difference in technology value

- Buyer's strategy is to concentrate all IP in a Tech Hold-Co
- The existing technology in Bermuda shall fade out and new technology shall be developed under Tech Hold-Co
  - Change in business model for Bermuda: goodwill write off
- American IP shall be transferred to Tech Hold-Co
  - Different technology value for transfer pricing than for IFRS 3



# Summary

## In conclusion:

| | |
|---|---|
| **For situations where IP is being valued, in particular** | 1. M&A deals where IP is an important part<br>2. Intra group transfers of IP<br>3. Sale of IP to a third party<br>it is important to consider that the tax value and the accounting value are aligned |
| **Post-BEPS the rules are changing** | And the difference between accounting and tax positions potentially bigger |
| **Failing to manage this can lead to** | 1. Unexpected tax charges post transaction<br>2. Higher overall tax costs<br>3. Goodwill impairments |

# Thank you

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