Mr. Jeffrey Owens
OECD
Paris

Dear Mr Owens

Consultation on OECD Discussion Draft on The Transfer Pricing Aspects of Business Restructurings

Thank you for asking for comments on the Discussion Draft ("Draft" or "the OECD Paper") released for public comments on the 19th September 2008. Everybody involved in today's cross-border tax environment knows the importance of the issues connected with Business Restructurings. Indirect taxes, permanent establishments, transfer pricing and valuation issues all raise serious risks of double taxation for multinational enterprises seeking to rationalise their business models and operating structures to meet the demands of the markets. We acknowledge the enormous efforts the OECD has put on producing the draft and take the opportunity to make the following comments on the Draft.

In order to highlight our key message on the problem to which we have recently run in practise in a number of occasions, we have decided to limit our comments on one specific aspect: **Business Restructurings that are carried out immediately or soon after the acquisition of the shares in the restructured entity from a third party**.

In these cases the acquiring company typically seeks to smoothen the integration process by transferring some functions, asset and/or risks from the target company to some of its already existing units. In these cases tax issues will typically interact heavily with International Financial Reporting Standards (IFRS) and related purchase price allocation (PPA). Given the current approaches that a number of countries are taken in this respect, more guidance is needed in this respect from the OECD. Specifically, a step-by-step guidance and e.g. a list of typical tax adjustments needed to adjust IFRS based PPA for transfer pricing purposes would be most welcome. By doing this, the OECD would really help cross-border business in avoiding the current problems and serious risks of double taxation and excessive cash tax outflows where PPAs are, as indeed often happens in real life, used as such to determine the level of conversion payments.

We wish to stress that the views and opinions expressed in this document are those of the authors[1] alone and do not necessarily correspond to those with Deloitte & Touche Oy, Deloitte Touche Tohmatsu (a Swiss Verein) or any of its Member Firms or their clients.

[1] The authors wish to thank Kirsi Vuorela (CEFA) for her valuable comments on an earlier draft of this paper.

Executive summary

In our detailed discussion below, we wish to bring to the attention of the OECD that:

- In the absence of specific guidance, **a number of countries takes – at the outset – the approach that** also in cases where identified single assets / functions / risks are transferred from an acquired entity immediately or soon after an acquisition of the shares in that company, **conversion payments made should cover all or significant parts of the goodwill allocated to PPA for IFRS purposes**. This approach is typically supported by post-conversion discounted cash flow analysis,

- Although the PPA can be, in some cases, be seen as an appropriate starting point for analyzing conversion payments, **the above mentioned approach –** that lacks theoretical foundation and in-depth understanding of various components of PPA based goodwill as well the underlying nature of the arm's length standard – **will in most cases lead to excessive taxation at the level of restructured entity and serious risks of double taxation**,

- **PPAs** – and especially the value allocated to goodwill – **should be adjusted for tax purposes** in a number of ways before any conclusions on conversion payments on the transfer of identified assets/ functions/risks are determined. Through real life examples we note below that these tax adjustments – where more guidance from the OECD is welcome – should include, but not be limited,
    - Expected synergies from left-behind identified assets/functions/risks of the acquiree (recognised as part of the goodwill in the PPA),
    - Left-behind workforce and potentially related valuable know-how, which is typically not valued separately in PPA (but recognised again as being part of goodwill) or if valued, is not given any significant value but merely estimated to correspond the value of recruiting new employees,
    - Left-behind in process R&D,
    - Going concern value of the restructured entity which clearly is not transferred as only single identified assets are being transferred,
    - Remaining goodwill - including synergies other monopoly related profit potential, potential overprice paid etc - which is not transferred but which the restructured entity may not either be able to capture on post-conversion arm's length transfer pricing basis. As discussed below, this does not though mean that the target company should be entitled to a corresponding conversion payment on this amount either.

- Finally, we note that **the rules under which tax authorities are allowed to re-open** related parties' **transactions** where the assumptions made at the moment of the transaction do not correspond with the actually realized facts **should also apply to opposite cases**. In *bona fide* business restructurings e.g. integration costs actually incurred typically end-up being significantly higher or realized synergies significantly lower than those estimated at signing. If the value attached to estimated synergies are captured (at least party) in conversion payments, one would hope that the rules adopted would also allow taxpayers to re-open their filings and make necessary adjustment. If not, we can ask why would the restructured party be entitled to any part of the future synergies – that do not exist at the transaction date but must be achieved in subsequent everyday business – even with the "possibility" of an upward adjusts at the same time when 100 % of the risks on realising those synergies would be at the level of the acquirer?

1. Background

As mentioned, we have in recent years run into the problem of how to define potential conversion payments in cases where multinational companies (MNEs) have recently acquired all the shares in, typically, their competitors, subcontractors or suppliers, and wish to speed up the integration process and realization of expected group level synergies by transferring some functions, asset and/or risks to some of the existing units within their organisation. Generally, after the business integration takes place, there is no more a separate organization or function dedicated only to the business of the acquired entity, but personnel and functions are integrated to the acquirer's existing business units. Acquired entities or businesses are typically not even regarded as separate cash generating units for IFRS goodwill testing purposes.

Although we understand the concern around more aggressive tax planning and related base erosion fears that have influenced the drafting as well as the emphasis of the OECD Paper, by focusing on this topic alone, we also wish to address the growing concern of the private sector in relation to bona fide business restructurings. Unless clear intergovernmental guidance and valuation principles are provided for these cases, cross-border businesses will face a serious and material risk of double taxation which will significantly undermine the influence of the massive work that OECD has already done on the topic.

2. Documentation

In the Draft emphasis is put on documenting the pre and post restructuring situation as well as the intention of the parties at the time of the restructuring.

It is stated in para. 50 of the Draft that

> In order to determine the arm's length compensation payable upon a restructuring to any restructured entity within an MNE group, as well as the member of the group that should bear such compensation, it is important to identify the transaction or transactions occurring between the restructured entity and one or more other members of the group. This analysis must include an identification of the functions before and after the restructuring, and an evaluation of the rights and obligations of the restructured entity under the pre-restructuring arrangement (including those existing under contract and commercial law) and of the manner and extent to which those rights and obligations change as a result of the restructuring

Further, in para. 53 it is stated that

> Where anticipated synergy gains are put forward by a taxpayer as an important business reason for the restructuring, it would be reasonable for the taxpayer to document, at the time the restructuring is decided upon or implemented, what these anticipated synergy gains are and on what assumptions they are anticipated. This is a type of documentation that is likely to be produced for non-tax purposes, to support the decision-making process of the restructuring. For transfer pricing reasons, it would also be reasonable to expect such documentation to provide an analysis of the effects of the restructuring on each affiliate or taxpayer (costs and anticipated benefits) as well as an assessment of the other options realistically available to it.

The above is in line with what one would expect from a prudent business manager, i.e. the decision making in connection with a business restructuring must be based on a well-founded decision making process driven by the anticipated benefits. As indicated in the Draft, the decision-making process is likely to be documented in some detail in the background material drafted for or in connection with possible project teams and board meetings. It should be noted that this documentation may not always be self evident and may present various options/scenarios to aid the decision making process, thus, at times possibly creating doubts as to what the key documentation to be maintained is for transfer pricing purposes. Nevertheless, as stated above, this is the type of documentation that one would expect to be drafted and to exist in connection to a properly planned and implemented business restructuring. However, the Draft seems to go further in its documentation requirements. Paragraphs 58 and 59 state that:

> 58. The application of the arm's length principle is based on the notion that independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that is clearly more attractive. Consideration of the options that would be realistically available at arm's length is relevant to comparability and pricing of the transaction (see paragraph 1.15 of the TP Guidelines) and also for the assessment of whether it would be commercially rational for a party to enter into the restructuring transaction in the context of the application of the guidance on recognition of transactions at paragraphs 1.36 – 1.41 of the TP Guidelines.
>
> 59. At arm's length, there are situations where an entity would have had options realistically available to it other than to accept the conditions of the restructuring, including possibly the option not to enter into the restructuring transaction. In such cases, in assessing the conditions of a business restructuring transaction, the entity would be expected to consider whether any of these other options is clearly more attractive, taking into account all the conditions including any compensation or indemnification for the restructuring.

Whilst it is realistic to assume that independent enterprises when evaluating a potential transaction and its benefits would compare the potential transaction to other options available to them and only enter into a transaction if they see no alternative more attractive, this is not always the case in connection to an intercompany restructuring. However, the Draft seems to indicate that in all cases an entity, be it an unrelated party or a member of an MNE, would be expected to consider whether any of the available options, including the option not to enter into the restructuring would be more attractive than the restructuring itself.

An entity belonging to an MNE rarely has the luxury of considering all possible or even realistic options to a restructuring. This holds true especially in cases where the target company has been acquired with the ultimate purpose of integrating the entity into the acquiring group. It may well be that the entity in question has no realistic means of even mapping all the realistically available options, let alone evaluating their attractiveness when compared to the proposed restructuring. Further, it is unlikely that though the option of not entering into a restructuring could be argued to be an option, the company in question is not in a position to decline the restructuring.

As stated above, e.g. anticipated synergy gains may be the driver for the restructuring and the draft recognises difference between group-wide and local synergies. According to paragraph 57 of the Draft

> Even where they increase group-wide synergies, business restructurings may lead to the dismantling of local synergies... This restructuring may create regional or group-wide synergies while possibly destroying the local synergies that might have existed between the local manufacturing and selling activities. Given that the arm's length principle applies on a separate entity rather than group-wide basis, local synergy gains or losses may contribute to the profit / loss potential of the restructured entity, and may need to be taken into account in the analysis of the transfer pricing consequences of the restructuring…

In these or other cases where clear business reasons can be put forward as reasons for entering into a restructuring, it should be sufficient for the company or companies to document the business drivers and reasons behind the restructuring in a manner that would be expected from a prudent business manager. The requirement to weigh the relative merits of all available options and to document this process would put an administrative burden on taxpayers that contradicts what stated in the TP Guidelines, where it is stated that the extensiveness of the documentation process should be determined in accordance with the same prudent business management principles that would govern the process of evaluating a business decision of a similar level of complexity and importance. It is further stated that the need for documents should be balanced by the costs and administrative burdens, particularly where this process suggests the creation of documents that would not otherwise be prepared or referred to in the absence of tax considerations (see paragraph 5.28 of the TP Guidelines).

The requirements for documenting the reasons for entering into a business restructuring or the available options, should not be wider that those already laid out in the TP Guidelines. Otherwise, a significant additional burden would be imposed over and above what would otherwise be required from a prudent business management perspective. In our opinion, the Draft implies a significant widening of the scope of documentation, increasing the administrative burden on companies to a level that in many cases will be way too excessive.

3. Determining the "exit charge"

3.1 General background on various valuation points of the restructured entity

The Draft contains useful guidance on how to arrive at the valuation methods to be used in connection with a restructuring. The discussion indicated below seeks to indicate additional factors that could be used to support the valuation of assets that are either left in the restructured entity or moved to the acquiring company soon after the acquisition of the restructured entity has taken place.

When considering typical key valuation points raised in an acquisition between third parties and the potential future restructuring of the target companies, at least the following values need to be taken into account:

- Value of the target before the acquisition,
- Value of the target at acquisition,
- Values allocated to various assets in PPA,
- Value of the assets/functions/risks moved to the acquiring company,
- Value of the assets/functions/risks left to the restructured entity.

The purpose of table 1 is to present the two first mentioned valuation points and the related PPA that the acquiring company has to do for IFRS purposes after the acquisition. The principal driver behind PPA is to bring greater transparency to the acquisition process, to identify and value the assets being acquired and to arrive at the net residual amount which will be attributed to goodwill. One cannot stress enough the importance of understanding the **underlying principles of PPA** and related valuation process, as well as the **tax adjustments** that are **needed**, when calculating the appropriate tax treatment of the restructuring.

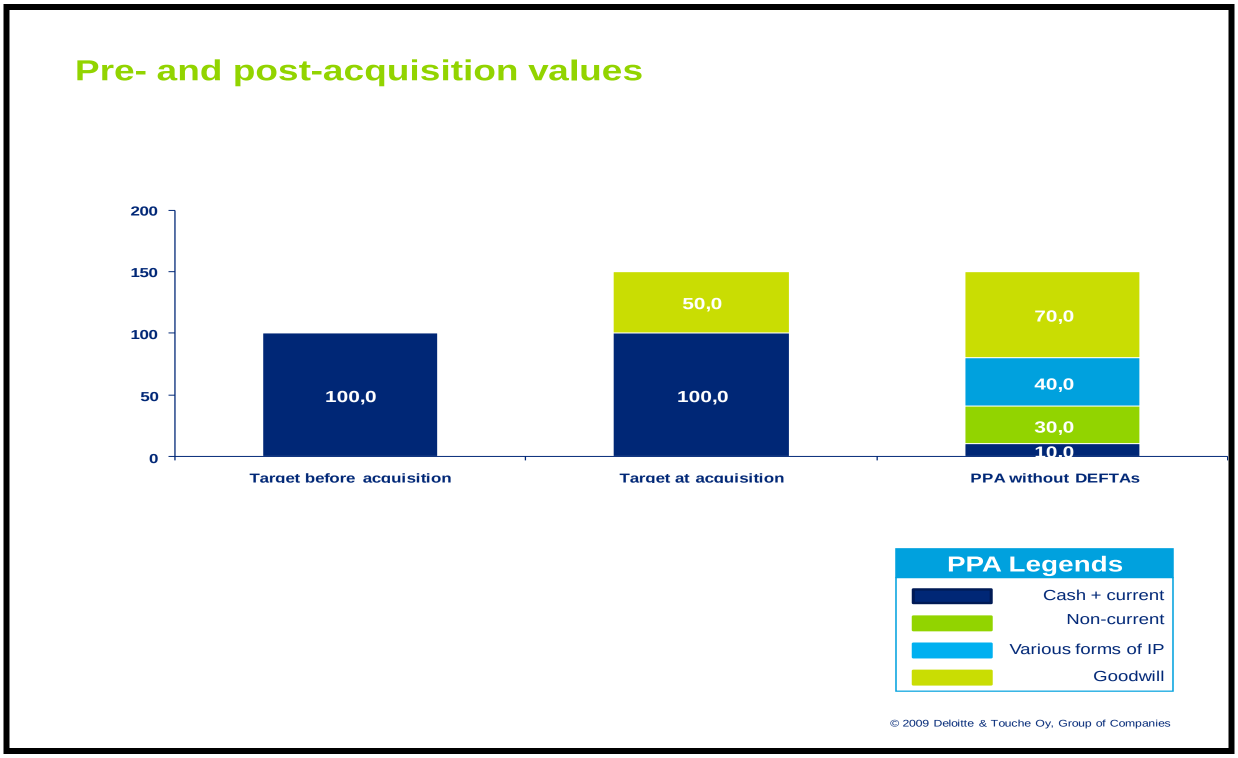


Table 1 illustrates that in addition to fair values of identified tangible and intangible assets, independent parties tend to pay a certain premium (50 in this case) when acquiring the shares of the target companies. This premium may typically include:

- expected synergies from the acquiree's net assets,
- items related to market imperfection,
- time-to-market and barriers to market entry benefits,
- economies of scale and other "monopoly related profits", as well as
- the value of the expected synergies from combining the acquiree's assets with the acquirer and on similar items in acquisitions.

International accounting standards name all this residual value upon PPA as **goodwill**. Goodwill represents **the residual value** left from the purchase price paid on shares after all identified tangible and intangible assets have been valued at their fair market value. What should be noted already here is that **IFRS do not**, however, **allow the acquiring entity to account for the fair value of the going concern element of the acquired entity, fair values of the synergies of the combined entities or fair values of certain other net assets** (including work in progress and know how related to target's employees) **as separate intangible assets[2], but these should rather be recognized as being part of the goodwill**.

Despite the above approach of the IRFS, it should also be noted that leading PPA-related literature has for a long time recognized that in principle residual goodwill may be dividend in smaller parts by introducing the concept of bottom-up perspective to the various components of goodwill.

> In September 1998 an article "Is Goodwill an Asset?" by L. Todd Johnson and Kimberley R. Petrone was published in Accounting Horizons (vol. 12 No. 3 pp. 293-303), a paper published by American Accounting Association. By the time the

[2] Under PPA process as adopted by the IFRS, intangible assets categories examples include marketing related intangibles, customer related intangibles, artistic related intangibles, and contract based intangibles as well as technology based intangibles.

writers were participants of Financial Accounting Standards Board. This article has been referenced to by several IFRS and US GAAP related writings since the article is seen as a foundation of the current perception of goodwill. According to this view, goodwill can be broken down e.g. to excess of the fair value over the book values of the recognized net assets, fair values of other net assets not recognized by the acquiree (incl. e.g. workforce, in-process R&D etc), fair value of going-concern of the target, fair values of synergies as well as later discussed elements of overvaluation and overpayments.

Our key concern is that many of these items representing the value paid for the shares will typically be captured at the level of the acquiring Group (either as such or by increasing the relative market position of the acquiring Group against competitors that will suffer due to the deal), rather than at that of the target company. Despite this, **many tax jurisdictions currently tend to, at the outset, require that all or most of such residual value should be compensated in association with Business Restructurings** that follows an acquisition to the extent the mode conversion would impact on parties' risk positions and future profit earning potentials (i.e. based on the "before and after analysis" of the expected results of the target/restructured entity). This holds typically true also in cases where only single assets / functions / risks are being transferred. As we seek to demonstrate below, this may not be always the correct approach and, though the Draft acknowledges the fact that the arm's length principle does not require compensation for loss of profit / loss potential as such, this should be addressed in much greater detail by the OECD.

3.2 Business reasons and valuation of synergies at the separate entity level

We acknowledge that, in line with the OECD Model and the Transfer Pricing Guidelines, the Draft promotes a separate entity approach for valuing any conversion charges on transferred assets / functions / risks independently from the actual purchase price paid on the shares.

We understand that this separate entity approach is, though somewhat vaguely, supported e.g. by the following quotes of the Draft

1) Comments on the synergies that may be created as a result of the restructuring as discussed in par. 57 *"**One important issue is the difference between group-wide and local synergies. Even where they increase group-wide synergies, business restructurings may lead to the dismantling of local synergies…** This restructuring may create regional or group-wide synergies while possibly destroying the local synergies that might have existed between the local manufacturing and selling activities. Given that **the arm's length principle applies on a separate entity rather than group-wide basis, local synergy gains or losses may contribute to the profit / loss potential of the restructured entity, and may need to be taken into account in the analysis of the transfer pricing consequences of the restructuring**, depending on the rights and other assets of the restructured entity at the time of the restructuring."*

2) Comment in par. 61 which states that *"**The arm's length principle requires an evaluation of the conditions made or imposed between related parties, at the level of each of them. The fact that the cross-border redeployment of functions, assets and / or risks may be motivated by sound commercial reasons at the level of the MNE group**, e.g. in order to try to derive synergy gains at a group level, **does not answer the question whether the transfers are arm's length from the perspectives of both the transferor(s) and the transferee(s).**"*

3) In addition, further support for the separate entity approach can be derived from the discussion related to the options that would have been realistically available to the restructured entity at arm's length (paras. 58 – 61 and par. 66). In this discussion, the OECD Paper recognises the need to consider the *"**options that would have been realistically available to the transferor and transferee at arm's length, based on the rights and other assets of each at the outset of the restructuring"***.

4) In issues involving intangible assets (par. 80 of the OECD Paper) OECD states: *"A feature of business restructurings is that intangible assets that were previously owned and managed by one or more local operation(s) are sometimes sold to a central location situated in another tax jurisdiction (e.g. a foreign related party that operates as a principal or as a so-called "IP company"). **The intangible assets transferred may or may not be valuable for the transferor and / or for the MNE group as a whole".***

Despite these various points of the Draft, the OECD should put more emphasis and give more details about the core fact that the options realistically available, together with separate entity approach, may provide strong evidence that the premium paid in the form of expected synergies etc should not necessarily be compensated at the local entity level. Consider the following example, typically seen in real life:

> Small listed target company (T) acts as a supplier for multinational Acquirer Group (A) and a number of other players in the same industry. The market capitalisation of T has been for long time at an average of 100 and clearly shows the fair market value of the company in case it would carry on its activities on stand-alone basis going forward. Group A could also continue buying goods and services from T at the same price its competitors are doing, but in order realise incremental value through economies of scale / monopoly related profits and other market imperfection related items (creating time-to-market and barriers to market entry related costs to its competitors and reducing similar costs for itself), Group A will make a public offering on T. The value of the bid which ultimately goes through is 150 and, thus, includes premium of 50 on top of the market capitalisation before acquisition.

When looking at the business rationale and related valuation reports that multinationals like Group A and their advisors typically produce in acquisitions like this, one quite easily notes that the synergies (i.e. the value of the premium paid) that the companies are looking after in many cases relate actually to the existing assets/future products and especially the market position of the acquirer group and its competitors, not the acquired and subsequently restructured entity as such. This should be highlighted in the Draft in a more clear-cut way.

Another point in favor of not compensating the target companies in full on the premium paid and the amount subsequently recognized as goodwill in the PPA relates to the current treatment of **overvaluation**[3] and **overpayment**[4] under IFRS. Conceptually, neither of these elements is goodwill under IFRS. However, in practice they often are since the amount recognized as goodwill for PPA purposes is always calculated as a residual after deducting all identified and measured (tangible and intangible) assets. Since any value explicitly earmarked to overvaluation or overpayment on the shares acquired **should be expensed immediately** after acquisition under IFRS (rather than recognising it as part of the purchase price paid in the balance sheet), MNEs may not be so keen on allocating any part of the price paid on these items for financial accounting purposes – but rather leave this as part of the residual goodwill. We do not fully appreciate the reasons behind the accounting treatment and the results that follow for PPA purpose, but, for the reasons mentioned above, one should not allow the IFRS based PPA to continue being the guidance that the tax authorises follow in determining the conversion payments.

Specifically, it should also be acceptable for acquiring companies to "overcompensate" the owners of the target entity at the time of the acquisition for achieving the said synergy gains, while the separate entity approach adopted by the OECD should more clearly support the approach that the overcompensation, whilst reasonable from a group level, is not necessarily deemed to represent the actual value of any synergy gains (or losses) at the target entity level. Thus, where the purchase price is (partially) driven by synergy gains, the effect on any conversion charge needs to be taken into account at the target company level so that the amount of overcompensation to be allocated as a basis of an exit charge can be lower than the actual amount paid as goodwill. It should not be captured at the level of the restructured entity, e.g. based on discounted cash flow analysis of its post-conversion situation.

[3] This may include possible errors in valuing the purchase consideration, such as in an all-stock transaction in which the value placed on the consideration is based on the current market price of the stock and the number of shares being traded daily is small relative to the number of shares issued in the combination.
[4] This occurs typically e.g. when the price is driven up in the course of bidding for the acquiree.

3.3 Reallocation of profit potential

The value and the price paid for the target company may include going-concern items allowing the entity to earn higher profits due to the organised collection of various assets and workforce. In addition, the acquirers' typically pay for profit potential from their Group perspective as indicated above. However, as stated in the Draft, this potential is not an abstract in connection with Business Restructurings but rather potential that is tied into rights or assets (see para. 64 of the Draft).

More OECD guidance is needed to state that in order to arrive at a proper arm's length remuneration for the restructured entity, the items carrying the profit potential need to be identified and valued on standalone basis. The OECD should stress that the valuation should be made based on the separate entity approach and based on separate assets that are being actually transferred, so that the valuation should be made at the level of the restructured entity from the viewpoint of the local potential. A prudent business manager of the acquired entity should maximise acquired entity's profit with optimised risks – and in deals between independent parties he would not know the valuation range of the counterparty (that is calculating potential synergies etc to the price). Typically, the options available for the acquired entity would be to either continue the activities "AS-IS", i.e. that is by not making any business restructuring and using e.g. CUP method to the extent possible with its parent company, or to maximise future profits of remaining activities and negotiate best possible compensation for potentially transferred assets/functions/risks. If the latter option is even slightly better, it should be the one selected. But is should not reflect the value that the acquireer has estimated to potentially realise.

As for the tangible and intangible assets where transfers are carried out immediately after the acquisition, the OECD should stress that PPA and related allocations to specifically identified assets should be used as the basis for the valuation, unless there are good reasons to the contrary. We base this strong recommendation on our understanding of the methods used by companies and their advisors in carrying out PPA exercises, which are typically well in line with the valuation methods used for transfer pricing purposes. For the sake of clarity, we also stress that PPA should be followed, at the outset, in other respects as indicated in more detail above and below.

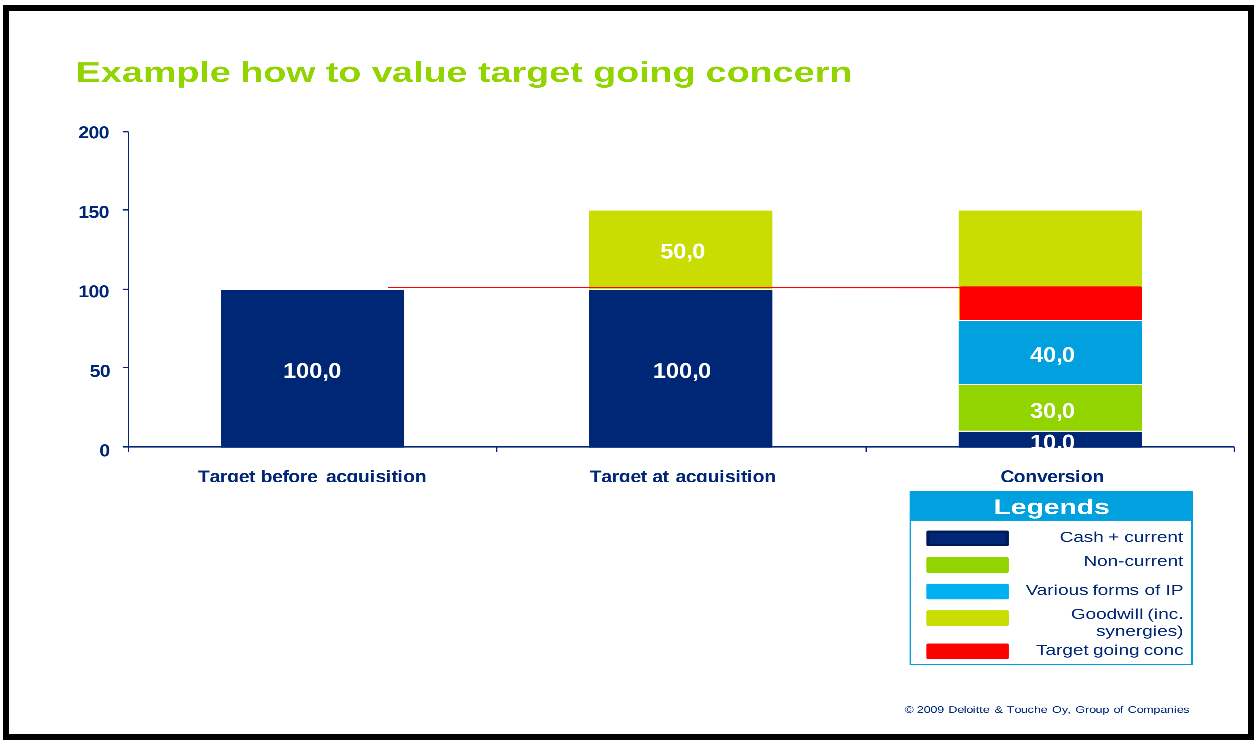
The Draft also discusses the case of a transfer of ongoing concern. This refers to a transfer of a bundle of assets as stated on par. 93 of the Draft:

> *Business restructurings sometimes involve the transfer of an ongoing concern, i.e. of an activity. The transfer of an activity in this context means the transfer of the total bundle of assets (possibly including contractual rights, workforce in place, goodwill, etc.) and liabilities associated with performing particular functions, including the inherent risks.* ***The determination of the arm's length valuation for a transfer of ongoing concern does not necessarily amount to the sum of the valuations of isolated elements that are part of the transfer****. In effect, transfers of ongoing concerns between independent parties often take account of any possible "goodwill", i.e. of the profit / loss potential (if any) of the activity transferred, from the perspective of both the transferor and the transferee. Valuation methods that are used in acquisition deals between independent parties may prove useful to value a transfer of activity, including goodwill, between associated enterprises.*

The above can be read to support the approach where the actual price paid for an acquired entity/business may not be the correct value for the transferred items or bundle of items in the restructuring following the acquisition. Whilst the current text "arm's length valuation for a transfer of ongoing concern does not necessarily amount to the sum of the valuations of isolated elements that are part of the transfer" may be read to indicate that the sum of valuations of isolated elements could be greater than the value of ongoing concern, it should be clarified that it actually also supports the need to value the items being typically transferred separately. This is the only way to make a proper valuation of the transferred items from the perspective of the transferor.

Here again some help can be derived from various sources relating mainly to PPA definition, as used for IFRS purposes. In fact, IFRS does not allow the acquiring entity to account for the fair value of the going concern element of the acquired entity as separate intangible assets in the PPA, but these should rather be recognized as being part of residual goodwill. To our understanding, in a number of cases this can be calculated and eliminated for post-acquisition restructuring purposes (and from conversion payments) where the transfer of an activity from the target to the acquiring Group does not determine the transfer of the *total bundle of assets*, including all contractual rights, workforce in place, entire know-how, goodwill, etc. and liabilities associated.

Distinguished writers have suggested that the **going concern component may be calculated e.g. as the difference between the target's pre-acquisition market value measured six days prior to the acquisition and the target's fair market value of assets**.[5] In table 2 below we have indicated how the PPA value could actually be broken down in various pieces with reference to pre-acquisition value to eliminate the value of going concern after the fair market value of the targets identified tangible and intangible have been valued. We do not see any reasons why an approach based on these lines should not be followed for tax purposes as well to avoid requirements on excess conversion payments based on the total amount of goodwill.



3.4 Compensation as a result of a business conversion

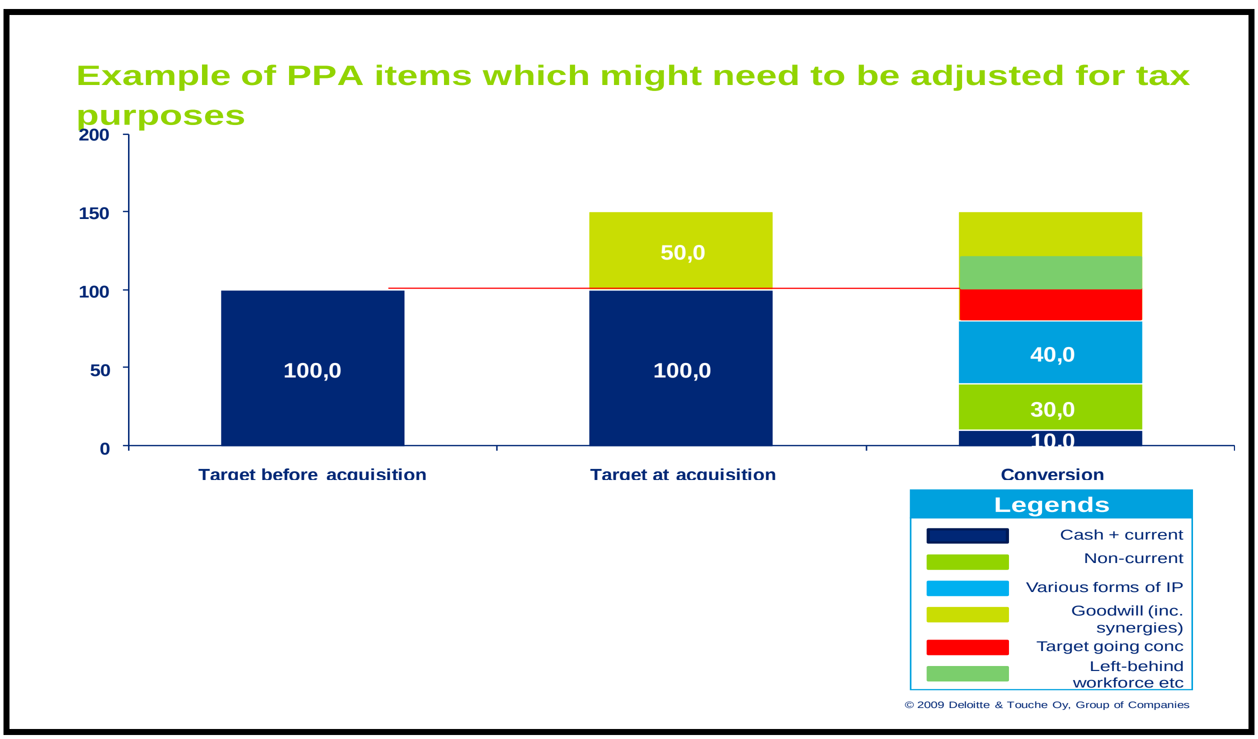
As a general rule, the Draft (paras. 66 – 70) suggests that the answer on Business Restructuring compensation should be based on comparison of the "before and after analysis" with reference to the

[5] To give an example of how going-concern can be given a price tag, one can refer to "Valuation of the Components of Purchased Goodwill" by Steven L. Henning, Barry L. Lewis and Wayne H. Shaw (Journal of Accounting Research, Vol. 38, No. 2 (Autumn, 2000), pp. 375-386).

profit / loss expectations of the transferor and transferee (taken into account the volatility etc of the business) before and after the restructuring. The factors that should be taken into account in the analysis should include e.g. options realistically available at the outset of the restructuring and the expected return to the transferor and transferee after the restructuring.

We agree with the approach in general, but would welcome more detailed OECD guidance as to the ways how compensation could be calculated, especially in those bona fide conversions that take place right after an acquiring group has purchased the shares in the restructured entity. This could be done by listing and explaining in greater detail the typical tax adjustments that are needed to adjust IFRS based PPA for transfer pricing purposes. By doing this, the OECD would really help cross-border business in their daily valuation and compliance work. For example, in relation to the case we have described in this paper, if we assume that the acquiring company is transferring only identified single assets / functions / risks (e.g. intangibles in table 3 below valued on stand-alone basis at 40), typical tax adjustment should include, but not be limited to:

- Expected synergies from left-behind identified assets/functions/risks (part of the goodwill),
- Left-behind workforce and potentially related valuable know-how which is typically not valued separately in PPA (but recognised again as being part of goodwill) or if valued, is not given any significant value but merely estimated to correspond the value of recruiting new employees,
- Previously discussed – and identified – going concern value of the restructured entity which clearly is not transferred as only identified IP is transferred,
- Remaining goodwill - including synergies other monopoly related profit potential, potential overprice paid etc - which is not transferred but which the restructured entity may not either be able to capture on post-conversion arm's length transfer pricing basis (as discussed above and below, this does not though necessarily mean that the target company should be entitled to a conversion payment based on the arm's length principle).



4. Concluding remarks

To sum-up, our concern is that the current wording of the Draft may lead revenue authorities around the world to include into the conversion payment such PPA items that would clearly not belong there. As we understand it, also the recently published temporary US cost sharing regulations support our above views. When discussing acquisitions of platform contributions to be included in cost sharing cost basis, the temporary regulations state that valuations prepared for financial accounting purposes are a useful stating point but not conclusive. The examples in the temporary regulations indicate that the IRS will first attempt to attribute financial statement goodwill to other platform contributions, such as workforce in place, in-process research and development, existing intellectual property, or other intangible property. Further, the examples and a companion example under the acquisition price method indicate that in the event financial statement goodwill cannot be attributed to platform contributions to be shared as part of the CSA, the reliability of the acquisition price method is reduced.[6]

When calculating the amount of conversion payment due on the tax adjusted PPA vis-à-vis post conversion situation of the restructured entity, one of the most critical element that is not highlighted clearly enough in the OECD Draft is also the discount rate applied on post-conversion cash flows. Typically, the restructured entity does not after conversion assume similar risks as before and the discount rate applied to value the fair market value of the remaining assets/functions/risks should also reflect this – and be clearly below e.g. WACC which would be used for fully-fledged acquirer.

Further, in the world where valuation methods and key value drivers of the business are as many as companies carrying-out related activities, one would wish that the OECD Paper would also state that the amount of conversion payment might not be an exact figure but rather a range of acceptable values; like in any transfer pricing exercise. This range might typically be derived by taking advantage of various valuation methods available etc.

Finally, an increasing number of tax jurisdictions are introducing rules whereby tax authorities are allowed to re-open relater parties transactions where the assumptions made by the taxpayers at the moment the transaction is carried-out do not correspond with the facts realized in the future. This approach – also recognized with due care by the OECD – is typically supported by arguments that third parties would not enter into such agreements without clauses that would allow the parties to re-open the pricing of the transaction.

One would hope that also the above coin had two sides. In a number of M&A related Business Restructurings e.g. integration costs (that the IFRS does not allow the acquiring company to account for in the PPA) paid by the acquiring entity and expensed in the profit and loss account to realize synergies may actually end-up being significantly higher than those estimated at signing when the purchase price and related price tag on synergies is decided. In a similar way, synergy benefits may just simply be much lower than those estimated. In case the revenue authorities in the target country are to capture even small amount of these synergies in the conversion basis upon subsequent Business Restructuring (unlike we feel that they should in most cases do), one would hope that – at least the OECD based – rules are adopted to also allow taxpayers to re-open their filings and deduct the non-budgeted and thus excessive integrations costs/adjust their conversion payments in other ways. If not, we can just ask why would the restructured party be entitled to any part of the future synergies – that do not exist at the transaction date but must be achieved in subsequent daily business – even with the "possibility" of an upward

[6] See also Deloitte publication "The new U.S. Cost Sharing Regulations: Past, Present and Future" (2009) by A. Shapiro et all for more on these rules. The publication is available at http://www.deloitte.com/dtt/article/0,1002,cid%253D245282,00.html

adjusts at the same time when 100 % of the risks on realising those synergies would be at the level of the acquirer? Such approach – taken currently by a number of countries – does clearly not comply with the arm's length standard.

In Helsinki on February 18, 2009

Yours faithfully,

Lari Hintsanen	Jukka Karjalainen
Partner	Partner
International Tax	Tax Aligned Supply Chain