TRANSFER PRICING

— and it's Impact on M&A Transactions

Mergers and acquisitions raise a whole host of transfer pricing issues from tax regulatory issues and compliance aspects to having influence over evaluation and business structure. In M&A transactions, the interaction between transfer pricing and purchase accounting can play a critical role in determining the allocation of the purchase price among the target company's tangible and intangible assets. Transfer pricing can also play an important role in selecting the financing structure of the proposed transaction.

M&A deals can often provide opportunities to harmonize existing policies. In developing consistency across the organization, a number of factors should be considered in determining which policies should be implemented. It can be difficult enough for acquirers to extract value for their shareholders from transactions and is harder still when due account is not taken of transfer pricing issues. It is therefore of the upmost importance for such companies to seek advice from leading experts to advise them best in this way.

Sang I. Ji, is a Tax Practice Partner at White & Case LLP. He comments: "Transfer pricing issues in the context of M&A transactions have become more prominent in the Firm's practice over the last several years for two key reasons", as stated below.

In addition to a higher proportion of M&A transactions that implicate multiple jurisdictions, taxing authorities worldwide have become more sophisticated in their search for revenues and often assert transfer pricing issues in the face of otherwise technically sound transaction structures. For these reasons, transfer pricing issues are front-and center in the minds of the Firm's tax practitioners focused on M&A transactions.

"Transfer pricing issues affect valuation of a target, because intercompany transactions that utilize inappropriate transfer pricing methodologies may implicate pre-closing tax indemnities (and related controversy provisions) that are subject to caps or deductibles.

In addition, some transfer pricing methodologies may shift net taxable income into post-closing periods, which could skew valuations on an after-tax basis. Also, the inertia resulting from sub-optimal transfer pricing methodologies may restrict a buyer's ability to restructure for post-closing periods. Indeed, all transfer pricing considerations ultimately affect the value of target to buyer or seller.

Transfer pricing issues in the context of M&A transactions also present opportunities for tax practitioners to become value-added service providers. The acquisition of target often will be the best time to make a change from prior practices and perhaps harmonize potentially inconsistent practices of buyer and target. Recently, we have seen transfers of intellectual property ("IP") outside the United States in connection with, or shortly following the closing of, M&A transactions. The complex licensing and sublicensing arrangements for intellectual property that are typical for transactions of this type require careful navigation of IP law to preserve standing and damage recovery theories and of tax law with transfer pricing issues of primary import. As intellectual property assets become the primary assets of our clients and their targets in the 21st century, we expect an increasing focus on transfer pricing issues."

Gene Kwee is Managing Partner, head of tax of VoskampLawyers, one of the largest independent international lawfirms in Singapore.

He comments: "The Singapore transfer pricing guidelines are in line with the OECD transfer transfer pricing guidelines for multinational enterprises and tax administrations. In addition to the aforementioned, there are specific provisions in the Singapore income Tax Act and guidelines/circulars that govern the at arm's length principle in related party transactions, related party loans and related party services.

These give guidance to Singapore taxpayers on how to apply the arm's length principle and how to arrange for the necessary in respect of preparing and maintaining documentation to ensure compliance with the arm's length principle. The guidance on arm's length principle and documentation requirements are applicable to all transactions, both local and cross-border, between a Singapore taxpayer and its related parties.

There are particular provisions in respect of Mutual Agreement Procedures and bilateral/multilateral Advance Pricing Arrangement facilities to eliminate or avoid double taxation where parties concerned are residents of jurisdictions with which Singapore has concluded Agreements for the Avoidance of Double Taxation."

WHY DOES THE INTERACTION BETWEEN TRANSFER PRICING AND PURCHASE ACCOUNTING PLAY SUCH A CRITICAL ROLE IN DETERMINING THE ALLOCATION OF THE PURCHASE PRICE?

"My perception is that the valuation of any such transaction would be driven by business valuations and considerations rather than by transfer pricing valuations. Nonetheless, both may come to the same conclusion. One of the considerations of transaction would be the identification of (intangible) assets that are part of the transaction and how such should/could be valued.

The answer of such a question comes to play as whether to determine whether independent parties would have paid the price accordingly may be substantiated by the price as set or determined by genuine business valuations."

HOW CAN TRANSFER PRICING AFFECT THE FINANCING STRUCTURE OF A PROPOSED TRANSACTION? AND HOW DOES THIS IMPACT THE BUSINESS STRUCTURE OF THE COMPANY?

"As per my previous remark, it has been our view that it is foremost a business decision or occasionally an issue how to arrange or facilitate the funding of such a transaction. It may be the case that a particular subsidiary contemplating the acquisition may not be able to get external funding and thus be reliant on intra group financing arrangements.

As such, tax effective structuring and transfer pricing issues for related party loans may come to the table."

> *"Tax effective structuring and transfer pricing issues may then 'lead' the discussion of the way how the transaction can be financed."*

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