

Tax Issues in International IP Transactions

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Tax Issues in International IP Transactions - Agenda

Introductions and Background

The Evolution of International IP Planning

Structuring IP Transactions

- Certain M&A Deal Considerations
- Certain Post-Closing Integration Considerations

IP Issues in Integration

- Concepts and Challenges
- Case Studies: Germany, Australia, Israel
- How to value IP?

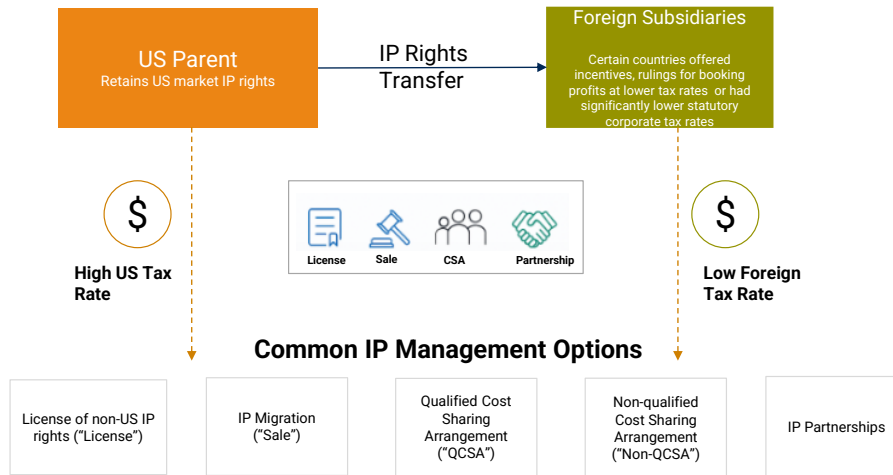
Other Stuff

Evolution of IP Planning

Classic US IP Planning: Pre-TCJA

- Prior to 2018, the US Corporate Tax Rate was quite high (Federal = 35%, plus State & Local)
- Certain Countries (Belgium, Switzerland, the Netherlands) offered rulings and incentives to allow for the booking of significant profits at significantly lower tax rates or had significantly lower statutory corporate tax rates (Ireland, Hong Kong).
- As result, corporate tax planning often involved developing and owning the economic rights to valuable IP in certain foreign location, while managing the US Subpart F (anti-deferral regime) and transfer pricing issues.
- This was particularly true of US-based technology and biotech enterprises. Options for managing the economic rights to the IP included:
 - License of non-US IP rights ("License Model")
 - IP Migration ("Sale Model")
 - Qualified Cost Sharing Arrangement ("QCSA Model")
 - Non-qualified Cost Sharing Arrangement ("Non-QCSA Model")
 - IP Partnerships
- Note: Typically, although not always, the US company retained the IP rights to a portion of the world, generally including the US market. This was due to US tax effectively connected income (ECI) and permanent establishment (PE) issues.

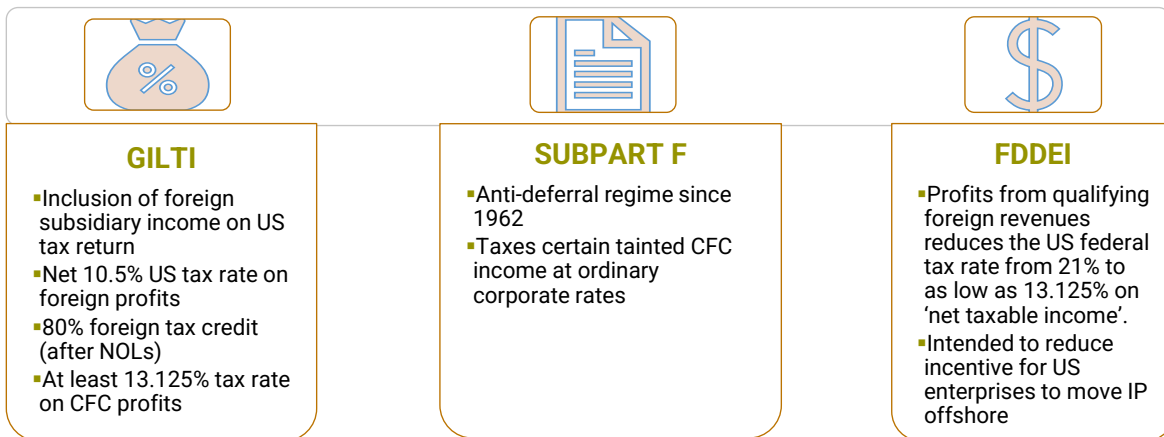
Classic US IP Planning: Pre-TCJA



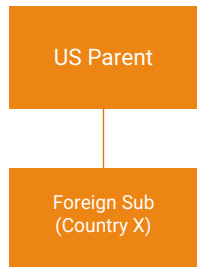
- Corporate tax planning often involved developing and owning the economic rights to valuable IP in certain foreign location, while managing the US Subpart F (anti-deferral regime) and transfer pricing issues.
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The Worm Turns: IP Planning Post-TCJA

US International Tax Reform - 2017



The GILTI Trap: Double Taxation?



Facts:

- US Parent is public company, provides management and other services; Possibly owns other IP.
- Foreign Co. subsidiary performs R&D, owns resulting IP.
 - Year 1: US profit of \$0/Foreign Co loss of (\$500)
 - Year 2: US profit of \$0/Foreign Co profit of \$200

Tax Results:

- Through Year 2, US has cumulative profit of \$0; the combined Group has a cumulative consolidated loss of (\$300).
- For US tax purposes, US has cumulative taxable income through year 2 of about \$200 and pays tax of about \$21 on \$200 x 50% of profit due to the GILTI mechanism.
- If US is not paying US corporate income tax, it will lose around \$200 of net operating loss carryforward due to the GILTI mechanism.
- **Query: what if Foreign Co performs R&D locally (Section 174)?**
 - **Or: Foreign Co pays US Co for R&D Performed in the US?**

Foreign IP Acquisitions: To Move IP or Not?

Arguments for repatriating Foreign IP to the US:

- Relatively low US federal tax rate on foreign sales (e.g., 14% - 16%)
- GILTI and FDII regime's make obtaining a substantially better overall tax rate difficult to impossible
- Potential Double Taxation on Foreign Entrepreneurial Activity (see previous slide)
- US use of foreign-owned related party IP may trigger substantial subpart F issues (deferral of tax on US use may be...difficult)
- Concentration of Tax Attributes and Entrepreneurial Risk in a Single Country (i.e., the US) is generally easier to manage and may lead to more predictable tax rate outcomes

Challenges with repatriating Acquired Foreign IP:

- Controversial/Expensive/Aggressive Local IP 'buy-out' rules
- Increasingly Vague DEMPE Rules regarding who "owns" IP, and how, and where, IP is created
- Potential loss of local tax attributes (such as Net Operating Losses, tax credits) due to "change in trade" rules
- Potential recapture of local R&D incentives

Often, it may be a question of choosing between short term pain, and long-term pain.

Recent Developments

The (Political) Elephant in the Room



- Will the current Administration's anti-trade policies incentivize companies to keep all or part of the Economic Rights to their IP offshore for political and trade reasons?
- Is the World Splitting into Trading Blocs?
- US IRC Section 174 rules appear to incentivize R&D to be performed in the US; but appear to be silent on ownership of economic rights (e.g., current year deduction of US-performed R&D; 15-year capitalization of foreign-performed R&D, no current disincentive for holding US-produced R&D outside of the US).
- Proposed HIRE Act – 25% Excise Tax on “Outsourcing Services”
- Section 174 capitalization/15-year amortization on foreign performed R&D services.

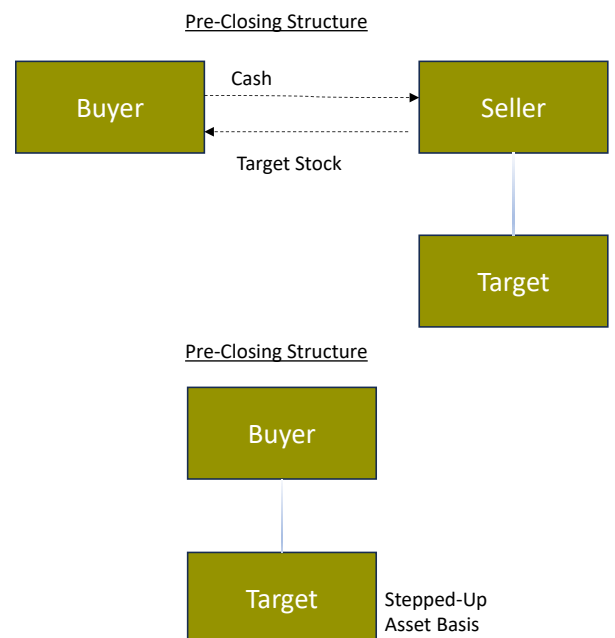
Structuring IP Transactions: Certain M&A Deal Considerations

Asset Versus Equity Transactions

- Asset transactions
 - Agreement typically sets forth exact assets purchased and liabilities assumed
 - Generally favored by buyers
 - Stepped-up basis in target assets (e.g., Sections 197 & 167)
 - Examples of deemed asset transactions:
 - Forward mergers
 - Disregarded entities (single-member LLC; Rev. Rul. 99-5)
 - Partnerships (Rev. Rul. 99-6; Section 754 election)
 - Check and sell transactions
 - Section 338 election (see subsequent slides)
- Equity transactions
 - Agreement typically provides for acquisition of all outstanding target equity
 - Generally favored by sellers
 - No stepped-up basis in target assets (unless deemed asset transaction)
 - Tax-free exchange/reorganizations
 - » Closing tax opinions/representation letters (public M&A)
 - » Statutory & regulatory requirements (e.g., continuity of interest requirement)
 - » Outbound transfer complexities (see subsequent slides)

Deemed Asset Transactions

- General Section 338 election requirements
 - “Qualified stock purchase” (QSP)
 - » Exclude preferred stock
 - » 80% by vote & value
 - » 12-month acquisition period
 - Only available to corporate and S-corp buyers
 - Not available to partnership or individual buyers
 - » Corporate holding company strategy
 - Election must be made before the 15th day of the 9th month following the month of the QSP
 - Certain post-closing events are permitted
 - » Successor to buyer
 - » Liquidation, merger or disposition of target
 - » Independent significance of QSP



Deemed Asset Transactions

- Section 338(g) election
 - 2 layers of tax
 - » Shareholder stock sale on acquisition date
 - » Deemed target asset sale by old target at the close of the acquisition date to new target that acquired such assets at the beginning of the day after the acquisition date
 - Unilateral election by buyer
 - » Made by the U.S. shareholders of a CFC buyer
 - Election for each target subsidiary
 - » Deemed asset sale at target subsidiary level
 - » Check the box election as an alternative (but note minority shareholders)
 - Typically made only in foreign target deals
 - » Foreign target typically not subject to tax on deemed asset sale (but note ECI/U.S. real property)
 - » Reduction of future subpart F income and GILTI/NCTI
 - » Facilitates efficient post-closing integration restructuring transactions
 - » Recent elimination of QBAI for NCTI purposes

Deemed Asset Transactions

- Section 338(g) election (cont.)
 - Target CFC implications
 - » Closes taxable year
 - > With the election, U.S. shareholder(s) generally responsible for pro rata portion of subpart F income and GILTI/NCTI arising from the deemed asset sale, pre-closing subpart F income and GILTI/NCTI and gain resulting from the sale of CFC stock
 - > Without the election, buyer generally responsible for pro rata portion of subpart F income and GILTI/NCTI for the entire year
 - > Creeping acquisitions (e.g., tender plus squeeze-out merger)
 - » Eliminates all CFC tax attributes in the hands of buyer (e.g., E&P, PTI)
 - > Mitigates compliance/reporting burdens
 - > Limitations on future tax-free dividends
 - » Trapped foreign tax credits
 - > Section 901(m)
 - > Disqualified foreign tax credits remain deductible
 - Post-closing indemnity or upfront purchase price adjustment

Deemed Asset Transactions

- Section 338(h)(10)
 - 1 layer of tax
 - » Deemed target asset sale by old target to new target followed by deemed tax-free liquidation
 - Only permitted in acquisition of U.S. target by U.S. or non-U.S. buyer
 - » Target must be member of consolidated/affiliated group or S-corp
 - » Availability of Section 338(g) election with respect to non-U.S. target subsidiaries
 - Bilateral election by buyer/seller
 - Post-closing indemnity or upfront purchase price adjustment
 - Cooperation mechanics agreed upon at signing
 - » Obtain executed forms by closing
 - » Purchase price allocation schedule

Outbound Stock Transfers

- Section 367(a)
 - Generally requires that a U.S. transferor recognize gain (but not loss) in an otherwise tax-free exchange/reorganization
 - » Transfer of property (other than IP subject to Section 367(d)) to a non-U.S. corporation
 - » Indirect stock transfer rules
 - General and specific exceptions:
 - » Active trade or business exception (repealed)
 - » Transfers of stock/securities of a non-U.S. corporation that is a party to the transaction
 - » Transfers of stock/securities of U.S. or non-U.S. corporations to the extent certain requirements are satisfied
 - "Gain recognition agreements" are entered into by 5% U.S. shareholders
 - » Generally require recognition of deferred gain upon the occurrence of triggering events
 - » 5-year period
 - » Extensive disclosure and compliance requirements
 - » Modifications for transfers subject to indirect stock transfer rules
 - » Tax attributes may be used to offset gain
 - Active trade or business test
 - » Engaged in active trade or business for 36-month period
 - » No intent to dispose/discontinue
 - » "Substantiality" requirement

Outbound Stock Transfers

Illustrative Example – Reverse Subsidiary Merger



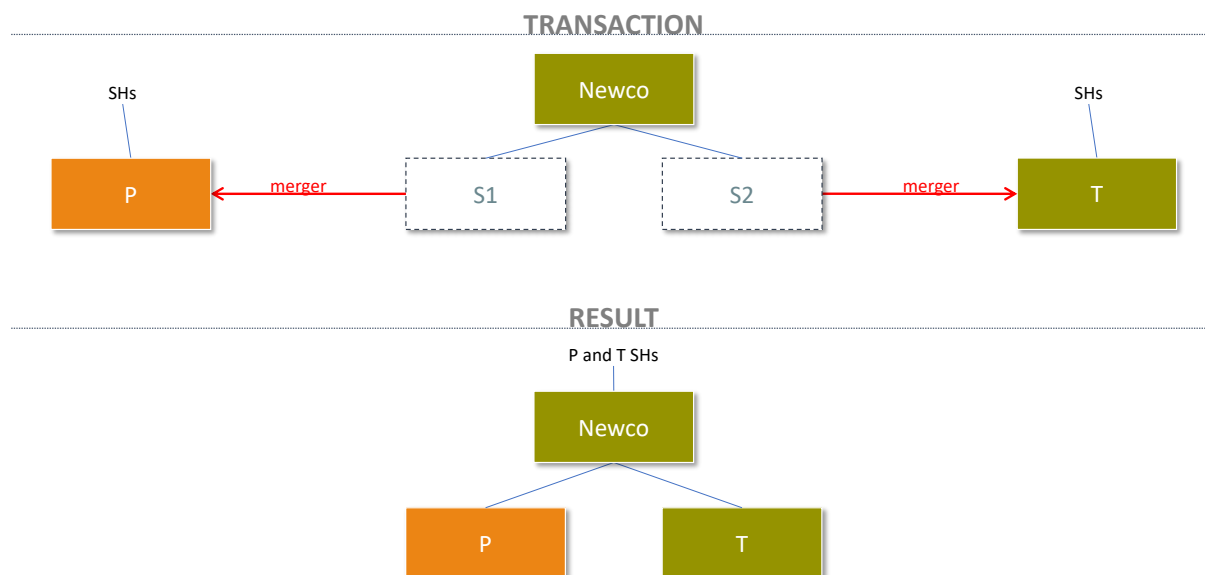
Outbound Stock Transfers

• Section 7874

- Generally applies to a non-U.S. corporation if 3 requirements are satisfied:
 - » Substantially all of the (direct or indirect) properties of a U.S. corporation are acquired
 - » Target shareholders hold at least 60% of the stock (vote or value) of the non-U.S. corporation by reason of ownership in target
 - » “Expanded affiliated group” (EAG) of the non-U.S. corporation does not have substantial business activities in its jurisdiction
- Ownership fraction: “by reason of” non-U.S. corporation stock / total non-U.S. corporation stock
 - » EAG stock excluded, unless “internal group restructuring” or “loss of control” exceptions apply
 - » Non-ordinary course distributions (NOCDs)
 - » Disqualified stock
 - » Cash-box rule
 - » Serial acquisition rule
- Surrogate foreign corporation (≥60% but <80% ownership)
 - » “Inversion gain” for 10-year period (limited tax attribute utilization)
 - » No qualified dividend income treatment
 - » BEAT implications
- Deemed U.S. corporation (>80% ownership)
 - » Non-U.S. tax residency not respected

Outbound Stock Transfers

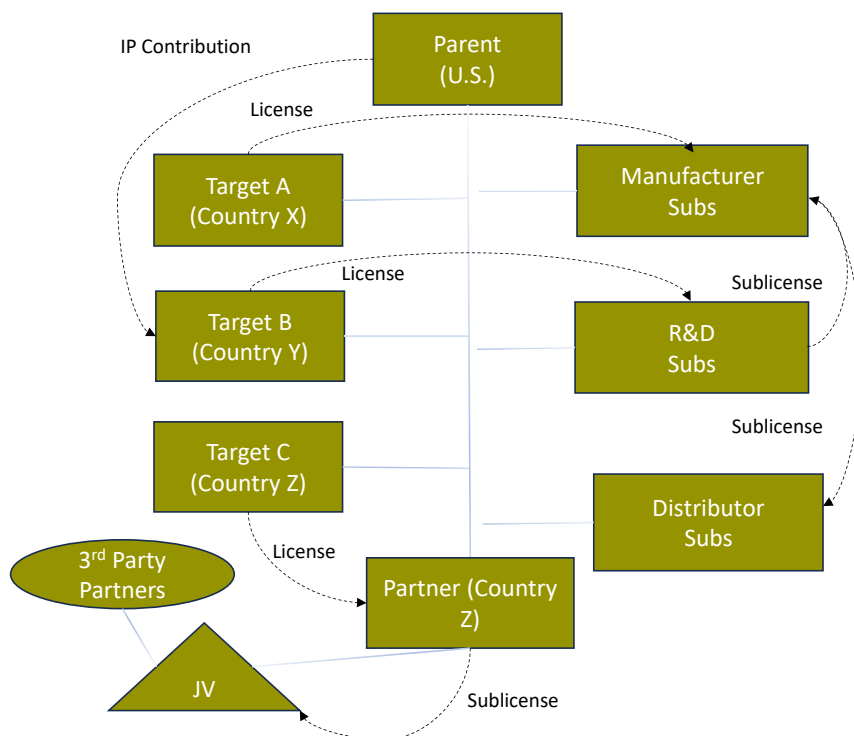
Illustrative Example – Double Dummy Structure



Structuring IP Transactions: Certain Post-Closing Integration Considerations

IP Integration Readiness

- Illustrative example
 - Target A: IP relates to marketed products
 - License to manufacturing affiliates in multiple jurisdictions
 - Sublicense to distributor affiliates in multiple jurisdictions
 - Target B: IP relates to research platform
 - License to R&D affiliates in multiple jurisdictions
 - Sublicense to manufacturing affiliates
 - Contribution of R&D-related IP to Target B
 - Target C: IP relates to joint venture collaboration
 - License to collaboration partner
 - Sublicense to joint venture partnership
- Tax diligence/modeling (e.g., ETR, withholding, transfer pricing, etc.)
- Pre- and post-closing covenants



Legal & Beneficial Ownership

- Legal owner is generally holder of legal title or contractual rights
- Beneficial owner is generally entitled to economic benefits and bears economic costs/risks of developing/exploiting the IP
- Section 482 regime
 - Legal owner is generally considered the sole owner of the IP, subject to 2 exceptions:
 - » “Control” standard if no identification of legal ownership
 - » “Economic substance” test
 - > Actual conduct/legal rights given greatest weight
 - > Other factors: consistency of conduct (contractual amendments); financial capacity; managerial/operational control
 - > Well-prepared legal documentation consistent with substance
 - > *E.g., Coca-Cola Co. v. Comm’r*, 155 T.C. 145 (2020)
- OECD DEMPE regime
 - Similar in concept to the economic substance standard but with key differences
 - Coordination with Section 482 rules

Sales & License Agreements

- General “substantial rights” test
 - Sales treatment if transfer is irrevocable, exclusive and perpetual
 - License treatment if less than all substantial rights are transferred
 - » Retention of rights to make, sell or use IP or grant licenses to others
 - » Other material restrictions on scope, duration or territory of use
- Section 1235 “all substantial rights” test
 - More restrictive than the general substantial rights test
 - Requires all rights that are of value at the time of the transfer
 - » Exceptions: legal title; security interest; forfeiture
 - All substantial rights not transferred if:
 - » Limited geographically to the country of issuance
 - » Limited in duration to less than the remaining life
 - » Rights in fields of use that are less than all the existing rights that have value
 - » Less than all the existing claims or inventions covered by the patent that have value
 - Form of payments not determinative

Sales & License Agreements

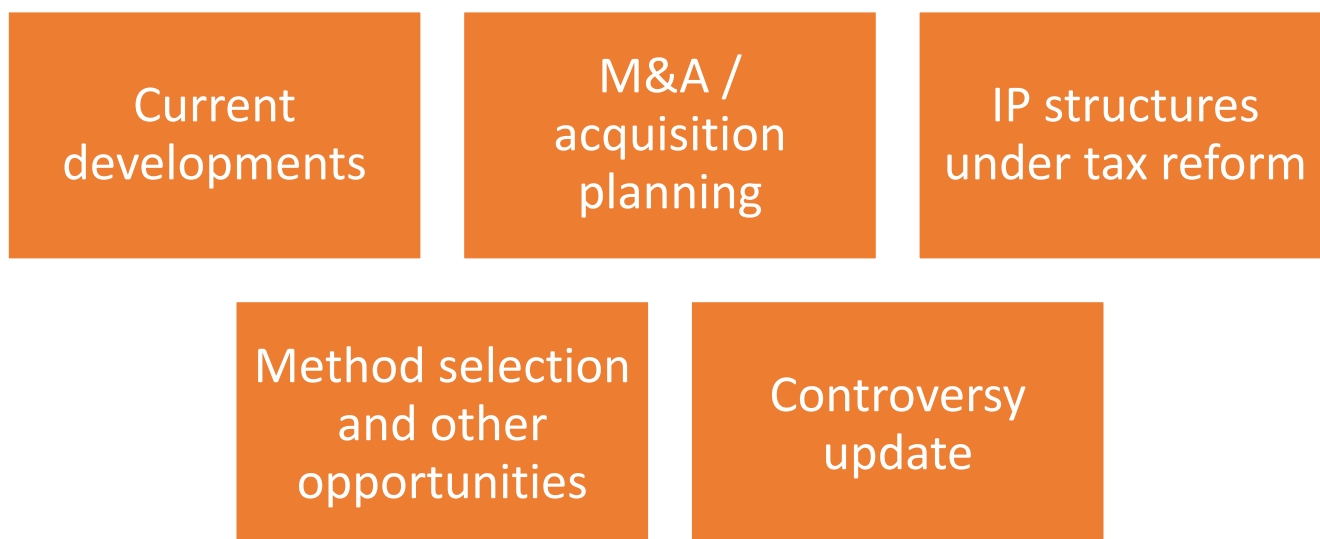
- Examples of sales agreement provisions
 - Transfer of all substantial rights
 - Territory the rights are intended to cover
 - Permanent and irrevocable nature of the transfer
 - No retention of control or economic rights
- Examples of license agreement provisions
 - Scope, duration and geographical limitations of the license
 - Right to revoke and modify by licensor
 - Restrictions on use or sublicensing by licensee
 - Expressly stating that beneficial ownership remains with the licensor

Outbound IP Transfers

- Section 367(d) generally treats the transfer of IP by a U.S. transferor to a non-U.S. corporation in a tax-free exchange/reorganization as a sale of IP for payments contingent upon the productivity, use or disposition of the IP
 - Patent, invention, formula, process, design, pattern and know-how
 - Copyright, literary, musical, and artistic composition
 - Trademark, trade name, and brand name
 - Franchise, license and contract
 - Method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, and technical data
 - Goodwill, going concern and workforce in place
 - Other items of potential value not attributable to any tangible assets or services of an individual
- Deemed annual royalty payments received over useful life of IP (20-year election available)
 - Section 482 arm's-length charge (commensurate with income), reduced by royalty paid to unrelated party
 - Treated as received on last day of U.S. transferor's taxable year (no advance payments/prepayments)
 - Blocked foreign income rules are inapplicable
 - Applicable to qualified successors
 - Accounts receivables established to reconcile deemed and actual payments
 - E&P reduction; deductions allocated to appropriate classes of gross income (e.g., subpart F income, GILTI, ECI)
 - FDII/FDDEI deductions
 - Basis consequences (carryover basis in transferred IP)
- Subsequent dispositions/acceleration events
 - Related and unrelated party transfers
 - Repatriation transfers

Current Trends and Audit Landscape

IP planning landscape



Current developments on intangibles

- IP Valuations in a post-TCJA / post-BEPS world have changed.
- US 482 Code vs. Regs are currently misaligned (367(d)(4), 1.482-4, 1.482-7).
- OECD Guidelines on intangibles post-BEPS are generally aligned with US rules but much softer on what intangibles are compensable (i.e., goodwill compensable depending on facts and circumstances).
- Other jurisdictions have added specific valuation requirements in their regulations.
 - *Germany: "Transfer Package"*
 - *Netherlands: Post-tax valuation; buyer and seller valuation overlap required.*
- Rules have made restructuring generally more expensive.
- Planning to assess the following becomes even more important:
 - *What intangibles are actually being acquired.*
 - *Value of intangibles, structure of payment, and potential losses / basis to minimize capital gains tax.*
 - *What intangibles can be amortized by the buyer to shield taxes on future IP profits.*
 - *Aligning economic substance / business purpose (the story) to the restructuring.*

Current developments on intangibles

Common jurisdictions that highly scrutinize IP transactions

GERMANY - Revisions to transfer pricing documentation rules effective from 2025 - Lower lead-time for report submission upon notification of audit - New requirement for a Transaction Matrix - Increased focus on intergroup lending	NETHERLANDS - Clarifications on transfer pricing mismatches - Implementation of Amount B - Relevant cases
AUSTRALIA - Focus transfer pricing related to R&D credits - Public CbCR - Imbedded royalty transactions (SaaS and others) - Guidance on intercompany financing	ISRAEL - ITA provides a formal ruling process affirming IP value and cost-plus treatment for an 8-year period. Requirements include: - Local entity meets "Preferred Technology Company" criteria and IP qualifies as "Beneficial Asset" under Encouragement Law. - Acquiring company had no material shareholding in local entity prior to acquisition. - Local IP sold within 30 days of acquisition closing. (difficult?) - IP sale value $\geq$ 85% (note) of adjusted enterprise value (including off-balance sheet liabilities and expected grant repayments to IIA), plus tax gross-up. - Company continues R&D services for 8-year ruling period. - Local workforce remains consistent with pre-acquisition levels.

Intangibles tax / transfer pricing planning landscape

Acquisition Integration



COMMON ISSUES

- Definition of intangibles for tax purposes is becoming broader; approach to value IP can make it too costly to move
- Identifying the entity(ies) who economically own valuable intangibles is not always easy. Economic substance needed to support ownership
- High risk of co-mingling of IP among affiliates if not addressed, especially in the software/tech space
- Transfer pricing policies / structure of acquirer and acquiree may not align
- Poor support (or lack thereof) for historical years could result in significant tax exposure, including penalties
- Managing dual finance systems



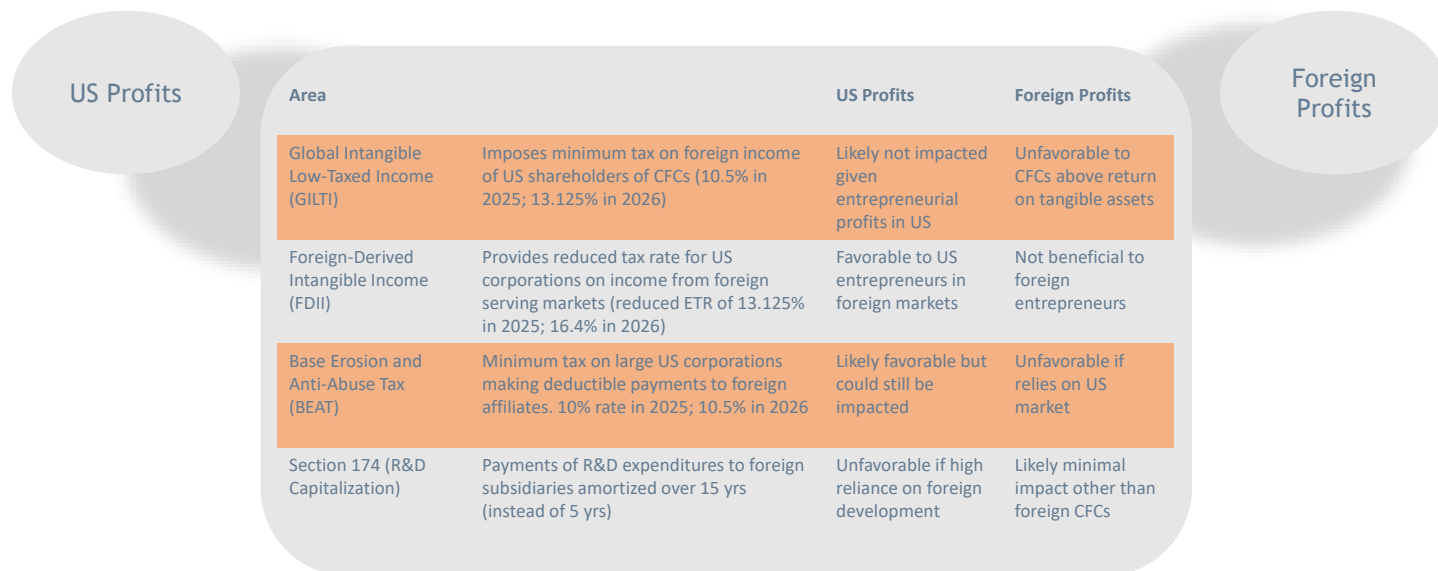
COMMON OPPORTUNITIES

- Revisiting transfer pricing models for combined business can be used to optimize the effective tax rate (ETR)
- Utilization of tax attributes
- Align structure to where cash is needed
- Appropriate transfer pricing can help better track business segment / entity level performance

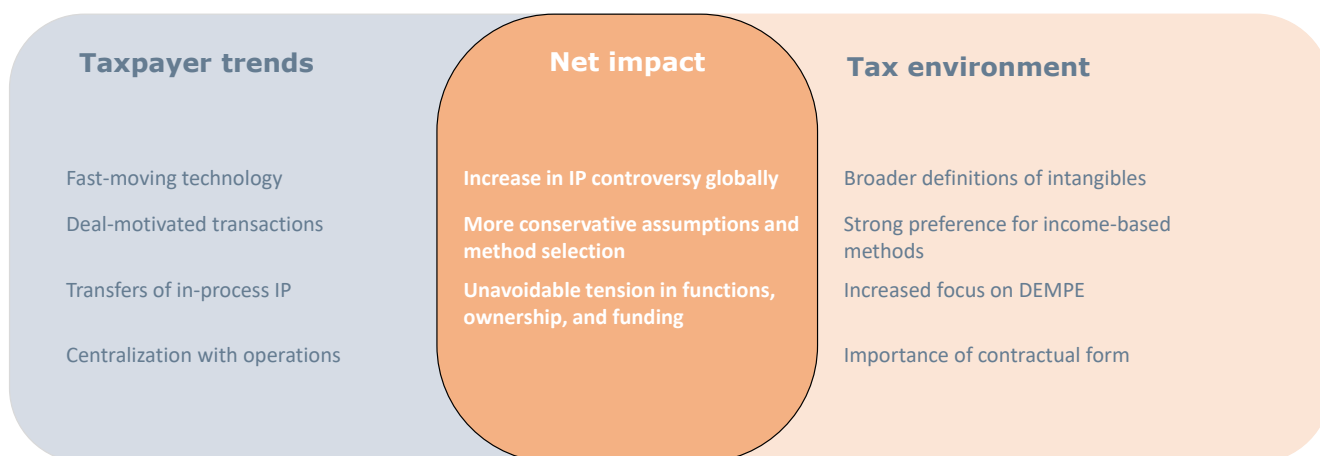
Intangibles tax / transfer pricing planning landscape

IP structures under US international tax provisions

Transfer Pricing / Tax planning has become more complex for US-based companies, especially with the reduced US corporate tax, and introduction of key international tax provisions under Tax Cut and Jobs Act (TCJA) in 2017. Impact to companies is not usually straight forward and often requires initial modeling to assess likely impact.



Macro observations for method selection



Additional opportunities

Increase in parallel planning- assessing profit allocation based on non-IP factors	Ongoing barriers to some countries, indirect tax impacts, and complexity	Interplay with tariffs
• Strategic management • ESG services • Distribution rights • Data IP and protection rights • Functional profit splits		

Case Studies: Germany, etc.

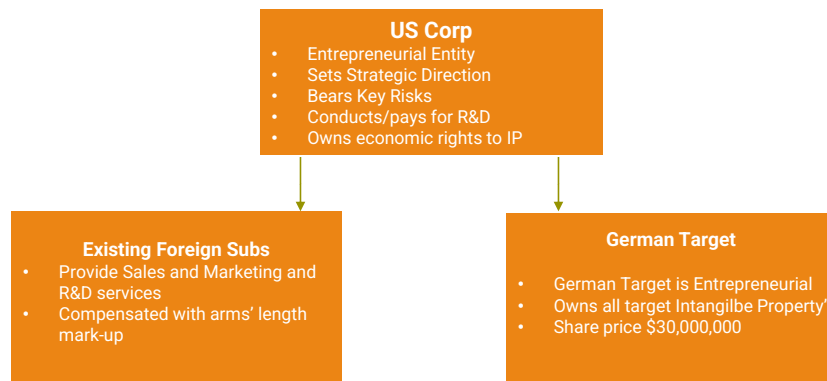
Acquisition of IP-rich German Target

Target Attributes:

- German Target is (historically) Entrepreneurial
- Owns all Intellectual Property ("IP")
- Purchase price of \$30,000,000

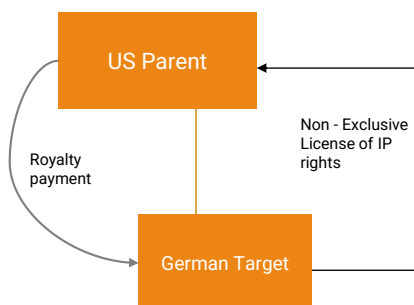
Following German tax attributes are available:

- Corporate and Trade Tax Losses - EUR 10,000,000

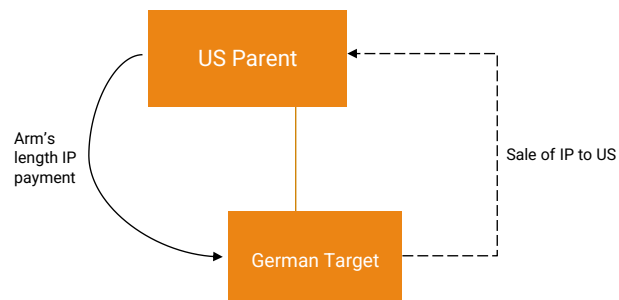


IP Management Options Considered and Key Tax Considerations

Option 1: Non- Exclusive License of Intangible Property



Option 2: Purchase of IP



German Acquisition: Options and Key Tax Considerations

Overall Acquisition Considerations

US Tax Considerations

Section 338(g) Election:

- If Target is not a CFC, US Corp may elect asset purchase treatment (Section 338(g)), stepping up asset basis (IP/goodwill) and amortizing over 15 years.

Foreign Tax Credit (FTC) Limitations:

- Section 901(m) may permanently disallow foreign tax credits (FTC) for the "disqualified portion" of foreign income tax paid on covered asset acquisitions, impacting GILTI and subpart F inclusions..

US Tax Compliance:

- Timely filing of Form 8023 (Section 338 election) and Form 8883 (asset allocation) is required.

GILTI and Section 174 (effects of TCJA):

- Potential Double Taxation of any net operating losses generated by target after acquisition.
- Capitalization and 15-year amortization of foreign R&D expenses vs immediate expensing of US-performed RD;
- Country of IP ownership is otherwise irrelevant.

German Tax Considerations

Loss Carryforwards:

- Significant tax losses (EUR 9.7M) may be forfeited if >50% shares are transferred, unless backed by hidden reserves or ongoing business activity (Sec. 8d KStG).

Transfer of Functions & Exit Taxation:

- Licensing IP may trigger exit taxation if functions (e.g., R&D, distribution) are relocated; properly structured licensing may avoid immediate exit tax, but law is evolving.

Minimum Taxation Rule:

- Losses can offset profits up to €1M/year; excess profits offset only partially (70% CIT, 60% trade tax). Lump-sum sales may limit loss utilization, while ongoing license fees allow more flexible offsetting.

Withholding Tax (WHT):

- Dividends to US Corp are subject to German WHT (25% + 5.5% surcharge), reduced to 5% under US-Germany DTA if treaty conditions are met (requires shareholder, substance, and LOB tests).

Germany: Options and Key Tax Considerations

Options: Non-Exclusive License vs Purchase of Intangible Property

US Tax Considerations

Foreign Tax Credit (FTC) Limitations:

- Section 901(m) may permanently disallow foreign tax credits (FTC) for the "disqualified portion" of foreign income tax paid on covered asset acquisitions, impacting GILTI and subpart F inclusions..

IP Licensing:

- Characterization as license or sale affects income sourcing and FTC eligibility.
 - Royalties are sourced to where IP is used.
 - Sales are sourced to seller's residence (but what about "commensurate with use of IP" purchase?)

German Tax Considerations

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Germany: Options and Key Tax Considerations

License vs Purchase of IP, con't.

US Tax Considerations	German Tax Considerations
Entity Status: CTB election: Target becomes disregarded for US tax.	Entity Status: CTB election: No impact; Target remains a corporation for German tax.
Liquidation E&P: Deemed liquidation; US Corp includes "all E&P amount" (minimal expected).	Tax on IP Transfer: IP transfer/royalty income taxable in Germany, regardless of CTB.
Dividend Treatment Deemed dividend may qualify for Section 245A DRD if holding period met.	Hybrid Mismatch Rules: CTB may trigger anti-hybrid rules; expenses may be non-deductible unless dual inclusion income applies..
IP Ownership: After CTB, IP is directly owned by US Corp; no separate gain recognition.	Dual Inclusion Income: Expenses deductible only if income is taxable in both countries by same taxpayer.
Anti-Hybrid Risk Consider not making CTB election unless easement provision applies	Easement Provision Recent guidance may allow deemed dual inclusion income case-by-case; uncertainties remain.

Determination of Arm's Length IP Value

Acquisition Price Method

Market-Based Approach

- The Acquisition Price Method (APM) under Section 1.482-7 operates similarly to a market-based valuation, using the purchase price as a proxy for the market value of contributed intangibles.

Reliability Conditions

- APM is most reliable when the transaction is between unrelated parties, the purchase price reflects fair market value, and the intangibles are the primary value drivers.

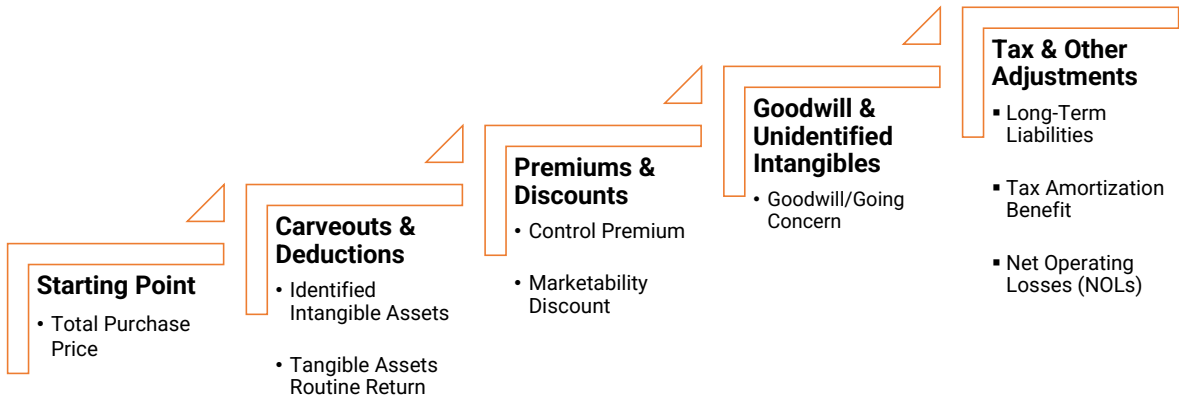
Commensurate with Income Principle

- U.S. tax rules require that the value assigned to transferred intangibles must be commensurate with the income they generate..

Step	Legend	Amount (USD'000s)
Purchase Price	A	\$27,000
Non-interest Liabilities	B	\$2,895
Identified Intangibles	C	\$7,200
Goodwill & Unidentified	D= A-B-C	\$18,473
Tangible Assets	E	\$4,281
Routine Return	F=(S&M NCP 5% R&D NCP 10%)	-\$7,800
Control Premium	G (22%)	-\$6,000
Tax Benefit	H	+\$1,600
Final Buy-In	I= D-E-F-G+H	\$11,900

Determination of Arm’s Length IP Value

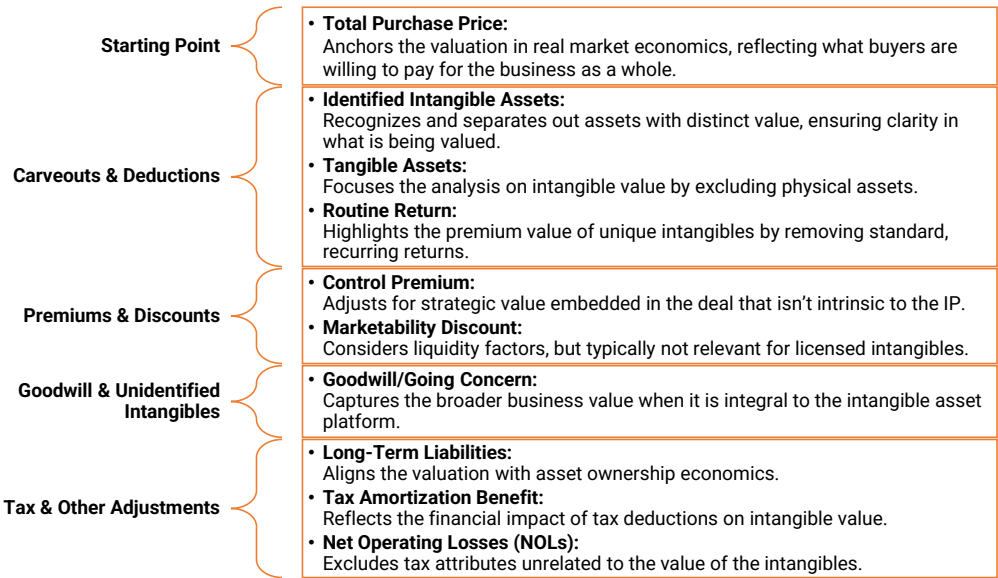
Acquisition Price Method – Key Adjustments



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Determination of Arm’s Length IP Value

Acquisition Price Method – Key Adjustments

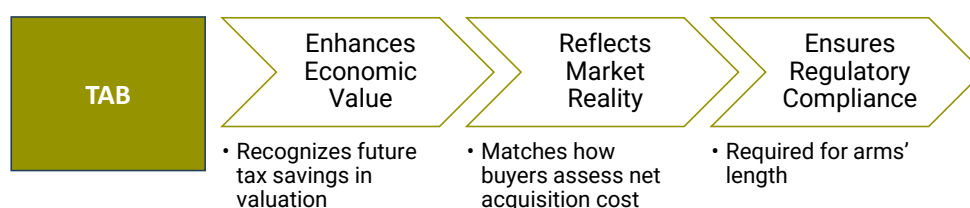


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Determination of Arm's Length IP Value

Acquisition Price Method – Tax Amortization Benefit ("TAB")

- **Critical APM Adjustment:** Ensures intangible valuations reflect their full after-tax value to the buyer, supporting robust, market-based, and compliant outcomes.
- **Enhances Economic Value:** TAB increases the effective value of intangibles to the buyer by factoring in the tax shield created by amortization deductions.
- **Reflects True After-Tax Cost:** Including TAB ensures the APM reflects the real, after-tax cost of acquiring intangibles, aligning the valuation with market realities and buyer economics.
- **Required for Arm's Length Analysis:** The IRS and transfer pricing regulations expect that valuations under APM account for TAB, as it is a benefit that would be considered by market participants in an arm's length transaction



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Determination of Arm's Length IP Value

Converting IP Value to Royalty Payments

Fiscal Year End (In USD, Thousand)	2025	2026	2027	2028	2029
Projected Revenue	\$1,615	\$4,507	\$8,372	\$11,302	\$14,693
Partial Year (IP License date – 08/01/2025)	0.42	1.0	1.0	1.0	0.6
Discounted Period	0.21	0.92	1.92	2.92	3.50
PV Factor	0.97	0.88	0.76	0.66	0.60
PV of Projected Revenue	\$1,567	\$3,947	\$6,349	\$7,420	\$8,869
Royalty Licensing Rate (Based on third party licensing search)	11.0%	11.0%	11.0%	11.0%	11.0%
Annual Payment Amount for the IP (PV of Revenue)	\$172	\$434	\$698	\$816	\$976
IP Useful Life	4				
NPV of Projected Revenue for 4 years	\$28,152				
Royalty Fees	\$3,097				
Implied Royalty Rate	11.0%				

Assumptions and Key considerations for converting IP Value to Royalty

- IP License Rate
- Royalty Rate
- IP Useful Life
- Revenue Projections
- Discount Rate
- Jurisdictional Tax Rate

APM Implied Royalty Rate for 4 years IP Useful life (\$11,900/\$28,152) is 42.3%

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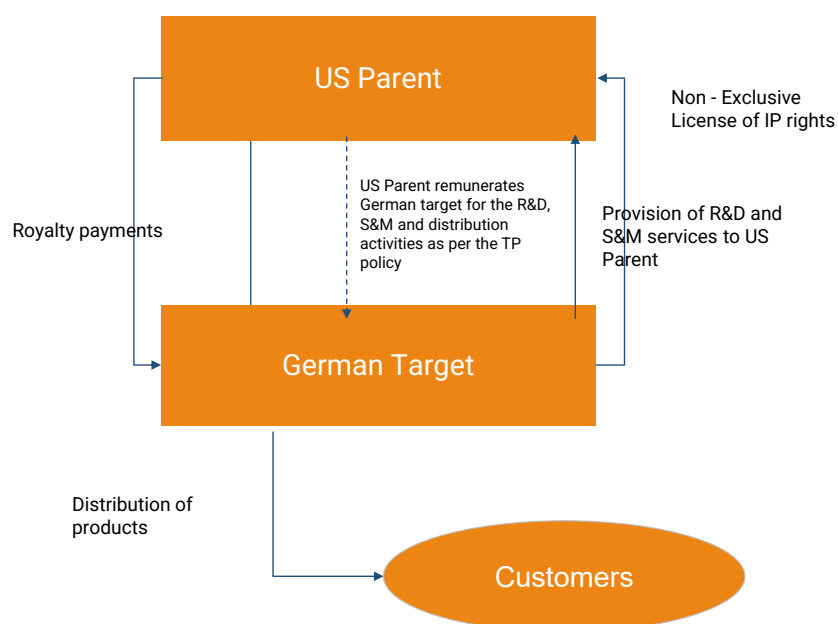
Determination of Arm's Length IP Value

Comparison of APM and RfR

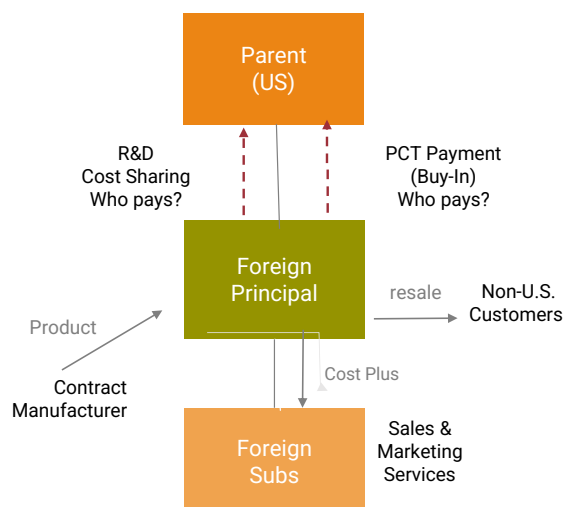
Aspect	APM-Derived Royalty	Relief from Royalty Method (RfR)
Conceptual Basis	Converts residual profit attributable to IP into an implied royalty rate.	Estimates value of IP based on hypothetical royalty payments avoided due to ownership.
Starting Point	Bottom-up: Begins with operating profit and adjusts for routine returns.	Top-down: Starts with projected revenues and applies market-based royalty rates.
Data Requirements	Requires detailed financials, functional analysis, and benchmarking of routine returns.	Requires reliable market royalty rate data and revenue forecasts.
Use Case	Common in transfer pricing to derive arm's length returns for IP owners.	Widely used in financial reporting, PPA, and tax valuations.
Assumptions	Assumes IP owner earns residual profits after compensating routine functions.	Assumes company would license IP if it didn't own it.
Complexity	Moderate to high: Requires multiple adjustments and benchmarking.	Moderate: Simpler if royalty rate data is available.
Valuation Output	Implied royalty rate or IP value based on residual profit.	IP value derived from discounted avoided royalty payments.

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Germany: Post Acquisition – Intercompany Transaction Flows



Trump Era Compromise: Cost Sharing no longer dead?



Overview

- **US Parent** forms a **Foreign Principal** in a low-tax jurisdiction.
- Foreign Principal acquires **non-US rights to existing IP** via a **Platform Contribution Transaction (PCT)**.
- A **Cost Sharing Arrangement (CSA)** is established between US Parent and Foreign Principal to co-develop future IP.
- **Foreign Principal** pays **R&D (or other) cost sharing payments** to US Parent for the portion of work related to non-US IP (net amount – both sides contribute).

Key Considerations

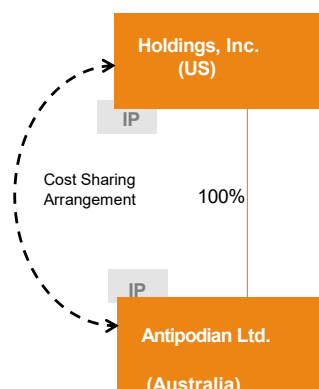
- **IP Profits:** Foreign Principal retains profits from non-US customer sales.
- **Tax Impact:** PCT payments may trigger significant upfront tax costs.
- **Payment Structure:** Can be structured as a **lump sum** or **ongoing royalty**.
- **Valuation Complexity:** Determining fair value for IP rights is challenging.
- **US R&D Deductions:** Potential loss of deductions, including **stock-based compensation**.
- **Funding Strategy:** Requires planning, but **cost sharing payments** offer built-in repatriation capacity.

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The Return of Cost Sharing – Australian Example

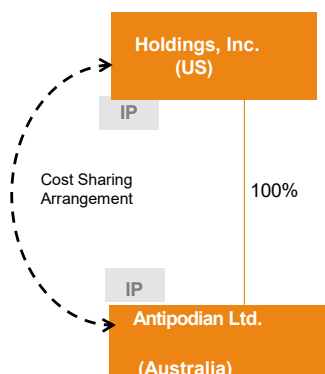
Cost Sharing Arrangement



- Under a cost sharing arrangement, US and Oz would jointly own the group's IP portfolio. Each party can exploit the group IP in its territory without paying royalties to the other party, provided the parties each contribute commensurately to the ownership and development of the IP (e.g., sharing development costs 50/50 in exchange for a 50% share of the world market for each participant).
- A cost share structure begins with a contribution of value. US and Oz would value the global IP and make initial payments (or contributions) of existing IP in "platform contribution transactions" to ensure that their starting economic contributions align with the intended split of the market / territories. Often, one entity contributes rights to its IP (in this case, Oz), while the other entity (US) must pay for its right to use the existing IP. Generally, the partner contributing cash does so in the form of royalty payments under a license agreement.
- Following the buy-in, PW US and PW NZ would both contribute to the future development of IP, a concept known as Cost Sharing. Each according to its reasonably anticipated benefit (RAB) share. In most cases, RAB shares are estimated based on revenue split as determined by the respective markets allowed to each participant.
- Cost sharing does not require each party to perform actual development functions consistent with their RAB share. Instead, parties simply share development costs based on their RAB shares. No markups are required on cost share payments.
- Development costs will include fully burdened R&D, marketing, and any other costs reasonable anticipated to contribute to the creation and maintenance of cost shared intangibles.
- If one participant is performing management or other services for the group, additional management fees may be required in order to achieve an arm's length economic result.

The Return of Cost Sharing – Australian Example

Cost Sharing Arrangement



US Tax Considerations

Revenue Recognition & R&D Cost Impact

- US will retain global revenues (excluding the market rights allocated to Oz) from exploiting intangibles, pays a royalty or license fee to PW NZ **only for the sales in its allocated market**.
- This may reduce the license fee or royalty paid for US tax purposes but may be offset by:
 - Direct R&D expenses incurred by US.
- Cost-sharing payments to Oz for shared R&D (if US is required to pay for a portion of the R&D performed by Oz to maintain its proportion of the required R&D costs.
- Buy-in royalty may give rise to Subpart F income at the Oz level, taxable to the US company.

Potential GILTI inclusions

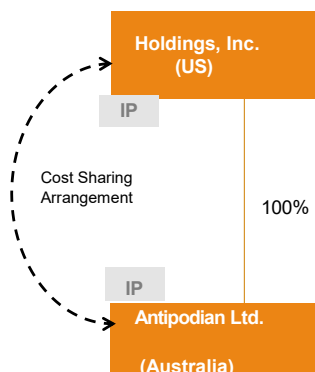
- GILTI (Global Intangible Low-Taxed Income) may arise from Oz's residual income:
 - No GILTI in high-tax years.
 - GILTI applies in low-tax years (e.g., when NZ uses NOLs), taxed at 10.5%.
- CSA does not create new GILTI exposure but maintains existing risks due to Oz's CFC status.

FDII Benefit

- Under the FDII section 250 deduction, the effective U.S. tax rate on foreign (non-US) qualifying income could drop to ~13.125% (does not include US state tax rates)
- This has the potential strategic benefit of shifting intangible income to a lower-tax U.S. environment compared to Oz's 30% rate.
- CSA structure aligns costs with benefits, avoids recurring withholding taxes, and positions profits in a potentially lower-tax environment (U.S. FDII or GILTI high-tax exclusion). Properly implemented CSAs are respected by the IRS, OECD and commonly used by multinational tech companies.

The Return of Cost Sharing – Australian Example

Cost Sharing Arrangement



Australian Tax Considerations

- Australia shares in the ongoing development costs and future benefits, likely deferring Australian income tax liability for the immediate future.
- Under a CSA, R&D costs are treated as **Intangible Development Costs (IDCs)** and are **shared proportionally** between US and Aus based on their reasonably anticipated benefits (RAB)
- Preserves business continuity, which may allow Oz to **continue using NOLs** against its share of development costs and future income.
- In a CSA, the payments are not subject to royalty or dividend withholding tax. Instead, intercompany payments are made to settle cost shares, but **royalty income may arise when rights are exploited or through the buy-in process** (i.e., 5% withholding tax on royalties paid from the US to Australia, or vice versa, per the US/Australian Bilateral Income Tax Treaty).

Israel – Guidance on local R&D Centers set up and Post Acquisition sale of IP

Introduction

- The Israel Tax Authority (ITA) has provided guidance on various criteria and requirements for certain local R&D centers and post-acquisition sale of IP.
- Following the guidance may provide income tax certainty for the taxpayer.
- However, the terms are not particularly advantageous.
- Are there alternatives?

Background

- Many foreign MNE maintain some form of captive R&D services in Israel, with majority applying cost plus a markup to the services cost base.
- The controversy with ITA is whether cost plus a markup arrangement is acceptable versus a profit sharing or even IP ownership and at what level.

Israel: Post-Acquisition Sale of IP – ITA Guidance

Ruling Oppty

- ITA provides a formal ruling process affirming IP value and cost-plus treatment.
- Ruling applies for 8 years.
- Is this process even beneficial?

Requirements for Taxpayer Qualification

- Local entity meets “Preferred Technology Company” criteria and IP qualifies as “Beneficial Asset” under Encouragement Law.
- Acquiring company had no material shareholding in local entity prior to acquisition.
- Local IP sold within 30 days of acquisition closing. (difficult?)
- IP sale value $\geq$ 85% (note) of adjusted enterprise value (including off-balance sheet liabilities and expected grant repayments to IIA), plus tax gross-up.
- Company continues R&D services for 8-year ruling period.
- Local workforce remains consistent with pre-acquisition levels.

Israel R&D Center Guidance

Cost Plus R&D Center

Local R&D centers compensated with cost plus mark-up



ITA Guidance for R&D Centers

ITA exam team can only challenge TP method if their dedicated technical team is involved and approves.



Criteria for Acceptance

- Foreign ultimate parent entity (UPE) has full control of local entity.
- Israeli tax residents/former residents hold $\leq 10\%$ control of UPE.
- Local entity engages solely in contract R&D per Encouragement Law for foreign resident.
- Income from R&D services to foreign residents is "preferred income" (eligible for reduced tax rates/incentives).
- Entity includes ICA, transfer pricing study, DEMPE analysis, benchmarking, and accept/reject matrix with annual tax return.

Developments in IP Controversy

Transfer pricing controversy involving intangibles

Key Themes

- U.S. cases still cover pre-2017 (TCJA) changes to intangibles.
- Strong preference for Income Method, but reliability of assumptions are heavily scrutinized.
- High emphasis on comparability when applying transactional methods and whether profit potential is appropriately considered.
- Form vs. substance (DEMPE)
- U.S. resource limitations yield an uncertain future; but high likelihood that foreign audits/scrutiny will increase.

Transfer pricing controversy involving intangibles

Optional

Case	Summary	Outcome	Key Takeaways
Facebook, Inc. & Subsidiaries v. Commissioner	• Involved platform contributions under 2010 CSA (Tech IP) between US and Irish subsidiaries. • Facebook valued PCT under a unspecified method (DCF approach) and arrived at \$6b value. • IRS applied income method with different assumptions (broader projections, CSA discount rate, RAB share based on gross profits into perpetuity) and arrived at \$19b value.	• Court agreed with IRS that income method should be applied, although with different assumptions. • Supported IRS view that RAB share should be considered in perpetuity • Rejected facebook's use of periodic adjustment clause to argue no adjustment to CSA required	• Use of reliable financial projections at the time of transaction (ex-ante) • Periodic adjustments tests do not function as a safe harbor for taxpayers. • Court rejected facebook's argument that 2009 Cost Share Regulations were inconsistent with ALS.
Coca Cola Inc., vs. Commissioner	• Case centered on US and its foreign supply points (syrup / manufacturers) who retained 10% mark-up and received 50% of the residual profits • Approach was accepted by the IRS under a 1996 closing agreement, but IRS argued in 2007 that supply points should be tested under CPM, • IRS argued over \$9b in TP adjustments between 2007-2009.	• In 2020, US tax court ruled in favor of IRS and reaffirmed its position in 2023. • Court rejected Coke's argument on blocked income provisions; stated IRS can sill allocate and collect that income. • Coca-Cola appealed the decision to the Eleventh Circuit Court of Appeals in 2024. • Resulted in over \$6b in deficiencies, penalties and interest paid to IRS.	• Prior IRS agreements, audits, positions do not drive future IRS positions. • Clear identification of IP owner that aligns with economic substance is important. Supply points aren't owners of marketing IP merely because they paid for marketing spend.
Medtronic vs. Commissioner	• Dispute revolves around license made to Puerto Rican subsidiary (manufacturer of medical devices) • Medtronic applied Internal CUT to price the royalty. • IRS rejected CUT method and argued CPM approach with Puerto Rican sub as tested party. • Tax court initially agreed with CUT (taxpayer position) but pushed for adjustments in 2016 decision.	• US Court of Appeals rejected both sides and adopted unspecified method that incorporated both aspects of CUT/CPM. • Appeals court in 2025 vacated and remanded a U.S. tax court decision that applied unspecified method. • Pushed Tax Court to reconsider IRS application under CPM	• Long running case that emphasizes the importance of considering adjustments and profit potential when applying a CUT.