

# Technical knowhow in post-merger integration

In the seventh in a series of 10 articles on tax-effective intellectual property (IP) management, **Hendrik Fügemann**, **Philip de Homont** and **Alexander Voegelé** of NERA present a case study on how to charge fees for knowhow in the BRIC countries.

A large European multinational company (MNC) had acquired a company with local entities in the BRIC countries. Following the acquisition, several of the MNC managers as well as external consultants were sent to these newly acquired local entities. Among other things, they introduced better management techniques, provided technological know-how, and improved the local operations. When the company headquarters tried to charge the local entities in the BRIC countries for these services, the local tax authorities did not accept the deduction of any costs related to this implementation team. At the same time, however, the group headquarters' tax authorities insisted in charging out these costs. The company was in danger of double-taxation.

## Solution

The NERA team structured a new charge system on the basis of the recipients' actual benefits. First, we identified the transferred technologies and other benefits. Then we reconciled our findings with those of the due diligence team, which included external management consultants.

The due diligence team had – roughly – estimated the increase in profitability and its sources for the post-acquisition period. We used these estimates as the basis for the calculation of the benefit-based charges for the first year. Additionally, we performed an expert survey to set up a benefit-based charging system for the subsequent years, which accounts for the various value-adding elements provided to the local entities post acquisition.

We also calculated the year-end true up and provided a fact sheet for the underlying legal agreements. The agreements were prepared by a local law firm.

Several issues had to be solved in the process:

- The isolation of the effects of the



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Before joining NERA, he worked at Ernst & Young as well as BDO and Warentreuhand. He has also developed a number of securitisation models for loans in the financial services industry.

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Recent project experience at NERA includes pricing strategy research projects on pharmaceutical drugs and telecommunication infrastructure as well as brand evaluations.

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existing local technology from the European technologies. Both had been developed continuously over the course of time.

- The key performance indicators for the provided value-adding elements.
- The data for the valuation of the benefits and the calculation of the charges.

NERA developed a system based on a combination of information from financial statements, internal documentation, and expert surveys. We have chosen representative experts for the different fields where the local operations in the BRIC countries were enhanced. The survey was conducted with both local and Western experts to obtain sufficient and unbiased information for the valuation of the benefits.

To yield a defensible assessment of the charges, the value of the contributions by the local technologies has to be respected. A precise evaluation of the rendered benefits is also achieved through a combination of several key performance indicators. We calculated the benefits that the local BRIC entities could have realised on their own and then assessed the surplus that the Western integration provided. This surplus was considered to be subject to a hypothetical negotiation, for which the bargaining power of the various parties was assessed. Defensibility of the different answers and a multitude of other aspects had to be considered. A system of thresholds avoids payments in difficult years, but leads to a fair net present value of future payments. This structure avoids unnecessary accumulation of loss carry forwards, while at the



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Alexander Voegele has more than 25 years of experience in transfer pricing. He has led hundreds of transfer pricing projects and provided economic advice on numerous defense cases for a variety of clients in a wide range of industries.

He edits the leading German handbook on transfer pricing, and is repeatedly listed among the "Best of the Best" transfer pricing advisers by International Tax Review and Euromoney.

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same time being fair to the recipient. Finally, time has shown that the charges were necessary and fair as evidenced by the acceptance by the tax authorities of the BRIC countries and local management.

**Fair and efficient**

The royalties provide the right split of profits between the contributing parties and – due to the chosen structure – continue to be fair and tax efficient.