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Cost Sharing and Buy-in Payments -- What's New?

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Cost Sharing and Buy-in Payments—What's New?

- 1. Importance of preserving grandfathered CSA status**
- 2. Acquisition Buy-ins under 2009 regs**
- 3. When does cost sharing make sense under 2009 regs?**
- 4. Impact of *Xilinx***

Potential Benefits of maintaining grandfathered status

- Preservation of non-exclusive territories
- Exemption from potential application of associated "capability variation" rule of Reg. § 1.482-7T(f)(3)
- Old periodic adjustment rules apply to new PCTs -- provided no "material change in scope"



Preserving Benefits of Grandfathered Status

- How to maintain grandfathered status
 - Conform agreement to 2009 regs
 - File requisite CSA statements
- Must also avoid “material change in scope”

“Material Change in Scope” of CSA

Objective: Avoid new Periodic Trigger (CWI) rules for new PCTs under grandfathered CSAs.

- Acquisition involving technologies in same general market space as Acquiror may not be “material change in scope”
 - Focus on Intangible Development Activity (“IDA”).
 - Determining factor is nature of R&D undertaking and market space – not direct product overlap.
 - Beware significant territorial expansion

“Material Change in Scope” of CSA (Cont’d)

- If new PCT would trigger a “material change in scope,” should consider a new CSA
- But...need to carefully weigh consequences:
 1. Loss of divisional interest protection
 2. Licensing/transfers between CSAs to ensure IP cross-fertilization must be appropriately accounted for
 3. Differential RAB share

Planning Approaches to Mitigate Impact of 2009 Regs On Acquisition Buy-ins

- Offshore IP
 - Licensing Alternative: Regs. §1.482-7T(a)(3)
 - Direct Acquisition by IPCo/deferral structure
- Offshore R&D Teams
 - Transfer directly into IPCo/deferral structure
- Foreign Marketing Intangibles
 - Transfer directly into IPCo/deferral structure
- US-Owned Foreign Goodwill/Going Concern Value
 - Tax-free contribution under IRC §§351/367(a)

Valuation Approaches to Denigrate or Adjust APM

- **Control Premium** – consider market cap of target before acquisition announcement
- **Routine Return** – maximize; consider alternative metrics and use of arm's-length range concept
- **Foreign Marketing Intangibles** (Acquiror or Target)

Valuation Approaches to Denigrate or Adjust APM (Cont'd)

- **Goodwill/Going Concern Value** (Acquiror or Target)
 - Note possible distinction between domestic and foreign
- **Finite Platform Life** – *Symantec* may well bear on this point, at least for pre-2009 buy-ins
- **Differential RAB Shares** – may not be realistic or advantageous to assume a speedy international ramp-up in RAB Share of Target's products
 - Or ramp up may be due to Acquiror capabilities

Other Possible Methods (Besides APM)

- Adjusted CUT Opportunities
- “New Wave” RPSM—if have offshore PCT
- “Old-style” RPSM – now relegated to Unspecified Method status, but (hopefully) not banished into oblivion
- Income Method (with adjustments)

Other Methods (Besides APM): General Methodology Considerations

- CUT related facts and financials can be used to support adjustments
- For RPSM approaches, presence of existing IP vs acquired IP is an issue in determining buy-in
 - E.g., Marketing intangibles
- CUT vs CPM variant of Income Method
- 2009 Regs sanction use of multiple discount rates
- 2009 Regs acknowledge non-perpetual platform life

Other Methods (Besides APM)

- **Bottom Line:**
 - Need creativity and closer examination of the operative facts to develop a well-conceived position on acquisition related PCTs under 2009 Regs.
 - Tax return and FIN 48 position
 - Conscientious early efforts are critical while the facts are fresh in everyone's mind.

Alternatives to Cost Sharing

- License of technology for royalty
 - Premium on good CUT (to avoid CPM)
 - More flexibility in handling acquisitions
 - Possibly use old style RPSM to reflect foreign developed intangibles
 - Marketing intangibles
 - Foreign R&D
 - Foreign goodwill/going concern value

Alternatives to Cost Sharing

- Contract R&D
 - Mark-up on R&D costs—how much?
 - “Principles” of 2009 regs may apply to associated transfer of pre-existing IP
 - Possible location savings play for lower cost foreign R&D if results of R&D shared with US service provider
 - More flexibility in handling acquisition buy-ins

Possible Advantages of Cost Sharing Even Under 2009 Regs

- Consider potential foreign PCTs
 - Foreign developed or acquired technology
 - Foreign R&D teams as offshore PCT
 - Foreign marketing intangibles
 - Foreign goodwill/going concern value—can contribute tax free for time being

Xilinx—What Next?

- 9th Circuit panel holds that stock option deductions must be shared under 1995 regs
- Petition for rehearing filed and briefed
- Appeals currently offering zero concession, but allowing issue to be left open in 870-AD
- Rehearing may tee up issue of whether IRS has power to contravene arm's length standard by regulation
 - Query possible impact on 2003 or 2009 regs?

Possible Advantages of Cost Sharing Even Under 2009 Regs

- Take advantage of dual discount rates
- Achieve ramp down of royalty if can support finite platform life
- Enhance CUT royalty with additional offshore return on R&D funding (at discount rate)
- Opportunistic conversion of valuation allowances or expiring tax attributes into lower future ETR