

Alert

June 2007

Valuation Integral to Execution of Tax Strategies

“Our valuation analyses can support both the tax-free treatment and proper tracing of tax attributes of the parties to the reorganization.”

Multinational corporations employ various strategies to reap tax benefits both domestically and internationally. A fair market valuation is often essential to the execution of such strategies. In this issue of the *Alert*, we highlight some of the strategies frequently used by multinationals.

REORGANIZATIONS

Corporate reorganizations can take the form of transfers of assets for stock or stock for stock. Both tax bases and fair market value of stock and assets transferred are required for proper reporting of these transactions under Internal Revenue Code (IRC) Section 367. Our valuation analyses can support both the tax-free treatment and proper tracing of tax attributes of the parties to the reorganization.

I.R.C. SECTION 338 - FOREIGN TAX CREDIT PLANNING

Sec. 338 elections are typically used for U.S. dividend planning. The stepped-up tax bases are used for increased depreciation and amortization deductions in the computation of U.S. earnings and profits. U.S. earnings and profits decrease while foreign taxes stay the same. As a result, foreign tax credit is accelerated. Our valuation analyses establish the stepped-up inside basis of the assets to provide the starting point for the U.S. tax earnings and profits calculation.

TRANSFER PRICING

Multinational companies face several compliance and planning issues in addressing the worldwide arms-length standards applicable to intercompany transfer pricing. Valuation analyses are integral to a worldwide transfer pricing strategy, particularly the proper valuation of IP for purposes of setting up a supportable royalty, tech fee, or other charges for access to the IP. In addition, economic analysis to determine the appropriate transfer pricing methodology is required to avoid underpayment penalties.

CHECK-THE-BOX

A check-the-box (CTB) entity classification election is permitted under U.S. tax law. This election to disregard the legal entity results in a deemed liquidation of the electing legal entity. In a liquidation, the stock of the legal entity is retired and the shareholders take over its assets and liabilities. The company is deemed to have sold its assets and liabilities for fair market value to the shareholders in return for their stock in the company. The shareholders are deemed to have sold their stock in the company in return for the fair market value of the assets and liabilities. A valuation is needed in order to determine the tax consequences of the liquidation and to establish the tax bases and capital accounts of the new legal entity.

FAIR MARKET VALUE ELECTION UNDER SECTION 1.861-9T(g)

For purposes of computing a U.S. taxpayer's allowable foreign tax credit, Section 864 (e) requires that interest expense deducted on the U.S. tax return be allocated and apportioned to U.S. and foreign source income. This generally adversely affects the allowable foreign tax credit since it results in an increased amount of interest expense being apportioned to foreign income and thus away from U.S.

continued on back...

Valuation Integral to Execution of Tax Strategies

income. The U.S. taxpayer can elect to use fair market valuation (rather than tax book value) to determine the relative value of the U.S. and foreign assets under the pertinent provisions of Section 1.861-9T(g) of the Tax Regulations. This election is particularly advantageous in situations involving U.S.-based intangible property with high fair market value but low or no tax book value.

“VRC has been involved in over 2,000 tax-related engagements.”

CASE STUDIES

VRC has been involved in over 2,000 tax-related engagements. Here is a sampling of some of the engagements we have completed:

- A multinational decided to utilize a check-the-box election for some of its poorly operating entities in Germany. We valued the equity of nine subsidiaries in Germany in support of the check-the-box election.
- A well-known bottling company with operations in the United States and overseas transferred assets to a country in a lower tax jurisdiction. The idea behind this strategy is that even though the company pays a one-time capital gains tax, in the long run the tax savings gained by utilizing this tax strategy make up for the one-time tax. To support this tax strategy, we provided a fair market valuation of the assets being transferred.
- A technology company engaged us to determine appropriate arm’s length royalty rates for intellectual property under I.R.C. Section 482 for transfer pricing. The arm’s length range of royalty rates provided a supportable basis for transfer prices between the Company’s U.S. (parent) reporting unit and multiple overseas domiciled subsidiaries.
- For a multinational which manages a portfolio of energy businesses we provided a fair value of the assets domiciled in the United States and abroad for allocation of interest expense in accordance with I.R.C. Section 864 (e) and Regulation Section 1.861-9T(g).
- We valued several overseas entities of a multinational supplier of analytical instruments, laboratory equipment and software for tax planning purposes.

For more information regarding tax-related services, contact your Valuation Research representative or Dick Nordberg at 414-221-6220. **VR**

Editor: Theresa Miller © Valuation Research Corporation. All rights reserved.



www.valuationresearch.com

Boston	617.342.7366
Chicago	312.957.7500
Cincinnati	513.579.9100
Milwaukee	414.271.8662
New York	212.983.3370
Princeton	609.452.0900
San Francisco	415.277.1800
Tampa	813.639.7691

International Affiliates:

Argentina
Australia
Brazil
Chile
China
Mexico
Spain
United Kingdom
Venezuela