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OECD/Base Erosion and Profit Shifting (BEPS) Intangibles Revisions to Change Character, Treatment of Goodwill

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Corporations acquiring intangible assets as part of business combination will no longer be able ignore goodwill in their subsequent restructurings and asset transfers. That's the upshot from tax authorities from around the world as the **Organisation for Economic Co-operation and Development (OECD)** issued its revision and update of intangibles and valuation as Action item 8 of Base Erosion and Profit Shifting (BEPS) project.

As part of the newly revised Chapter 6 (Intangibles) of the OECD's Transfer Pricing Guidelines, goodwill (as well as going concern) will now be characterized as a compensable intangible, similar to patents, trademark or know-how. Moreover, the Guidelines propose that (similar to pending U.S. legislation) that goodwill must be taken into consideration as part of any cross-border transfer of identifiable intangible assets.

Current financial valuation practice limits explicit valuation to the identifiable assets of a business combination as discrete, separable assets, with the remainder of the purchase price lumped together as goodwill. Subsequent tax valuations often use the discrete asset values as the basis for the allocation and post-acquisition integration of assets among the restructured and/or newly created entities, with the goodwill value shunted aside.

The OECD initially brought attention to this phenomenon as part of its Chapter 9 Business Restructuring guidance in 2010. More recently, the global heads of state, G-20 called out this practice, along with several others, as weakening the international tax system in the base eroding and shifting of profits (and potential tax revenues) to low tax or no tax regimes.

The new Guidelines would seek to effectively end, or significantly curtail, such practices, instead proposing an entirely different paradigm in which the value of goodwill is allocated and bundled with identifiable assets and taken into consideration in any subsequent transfer of intangibles.

While tax authorities recognize that financial/accounting valuations provide a useful "starting point" for intangibles determination, they assert such measures do not correspond with the arm's length value for transfer pricing purposes, and the values ascribed to intangibles as part of purchase price allocations will not be determinative for transfer pricing.

The change is a sharp contrast to existing and long-standing accounting and legal practices and principles, which recognize goodwill as the unidentifiable residual; the excess of consideration (cost) transferred over the fair value of identifiable (net) assets acquired.

Tax authorities around the world, including the U.S. Internal Revenue Service (IRS), have been unanimous in their assertion that the true value of a business is subsumed in both its identifiable and unidentifiable assets, and that to ignore goodwill is to ignore "an important and monetarily significant" part of the value of a business enterprise, and especially the value associated with key intangible assets of an enterprise.

Taxpayers should be advised that intangible valuations developed in the course of purchase price allocation (PPA) engagements will likely not be accepted—and are likely to be highly scrutinized– by tax authorities as part of post-acquisition restructurings.

Tax advisors and valuation professionals should be similarly apprised that they will have to more carefully evaluate the assumptions underlying their valuations of intangibles for transfer pricing purposes. In particular, this will require a closer and more deliberate evaluation and delineation of the components underlying the value ascribed to goodwill. Such an evaluation should be detailed enough as to define both the source and substance of these components as to demonstrate, distinguish and ultimately to defend, the value and allocation of goodwill for transfer pricing as opposed to PPA/financial reporting purposes. This will be necessary not only for the subsequent discussions with tax authorities, but also, and more likely and more immediately, with external auditors for purposes of both transfer pricing and tax provisions.