

# EXHIBIT 4

## (Part 2)



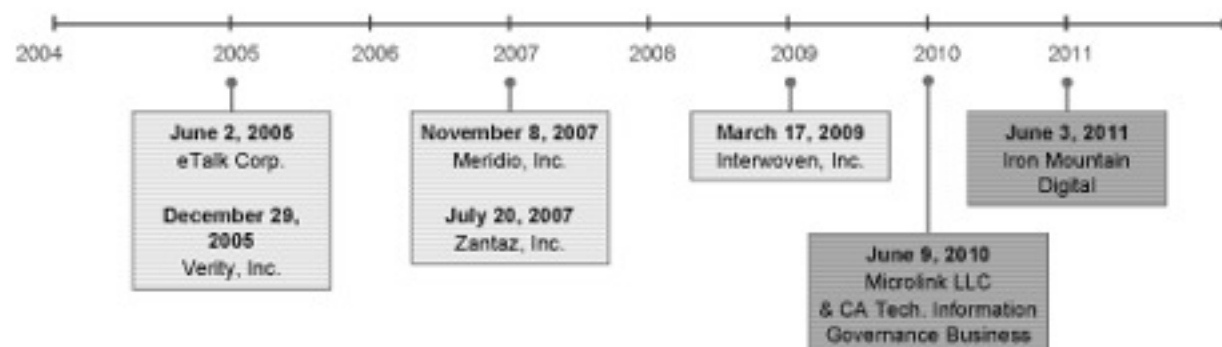
## Supporting analysis

## Target taxation - acquisition timeline

- **Meridio:** On November 8, 2007, Target acquired 100% of the stock of Meridio Holdings Limited, a company based in Belfast, Northern Ireland, and a provider of records management software and licenses, for \$61.0 million.
- **Verity:** On December 29, 2005, Target acquired 100% of the stock of Verity, Inc. for \$501.9 million. Verity, based in Sunnyvale, California, is a provider of software solutions for the enterprise search market and the business process management market.
- **eTalk Corporation:** On June 2, 2005, Target acquired 100% of the stock of eTalk Corporation, a company based in Dallas, TX, for \$72.7 million. In the purchase, Target acquired an audio search and a call center.

Of the stock acquisitions, Interwoven, Verity, Zantaz, Meridio, eTalk, and stock acquired from Iron Mountain, currently remain legal entities represented on the organizational chart. With the exception of Meridio, all are part of the U.S. Group. Management represented the foreign subsidiaries acquired in U.S. acquisitions are largely dormant. These foreign operations have been integrated with legacy Target local country operations, and none operate autonomously.

Management represented that they recently contemplated a legal entity rationalization project, but to date no action or implementation has been pursued. We have not been provided with a definitive list of active U.S. or foreign entities.



Source: Public documents including: Investor Forum 29 November 2010; Press release Iron Mountain Digital Acquisition 18 May 2011; Target's 2005 through 2010 Annual Report & Accounts.



## Supporting analysis Target taxation - tax overview

Management represented that Target has no internal tax function.

### Current status of tax function

Sushovan Hussain, Target's CFO, has the overall responsibility for Target's tax affairs.

During discussions with management, management represented that Target has no internal tax function, instead using one to two individuals from the finance group as "tax processors." The tax processors primary function is to gather source materials for Target's external tax advisors. Any other staff providing source material and source reports from Target's enterprise software are extensions of the finance group and are not performing any tax analysis or planning.

### Reliance on external tax advisors

Target relies on external tax advisors for U.S., U.K., and international compliance, as well as for any tax planning.

With respect to U.S. compliance, management represented that PwC has provided all U.S. compliance for the U.S. Group since 2001.

With respect to U.K. compliance and planning, management represented that E&Y Cambridge has provided all U.K. compliance and planning since 2001. Namely, Cathy Taylor has been instrumental in providing services and has helped implement the "Tower Structure" used by Target to finance the most recent U.S. acquisitions.

With respect to international compliance, management represented that E&Y as well as local firms provide compliance for all non-U.K. and non-U.S. subsidiaries.

Deloitte served as Target's auditors since 2001, and in addition prepared TP documentation. Management represented that with respect to TP documentation, they have worked closely with Richard Blackwell.

### Tax control environment

Historically, Target focused on ensuring that it met U.S. and U.K. compliance obligations rather than implement tax strategies to reduce the consolidated ETR.

Although in recent years Target has implemented a financing structure, the "Tower Structure," which enables the U.K. Parent to benefit from tax relief on financing costs without a corresponding credit being subject to tax in the jurisdiction lending the funds, the U.K. Provided this structure has been implemented correctly, the tax risks associated with this planning are manageable. Please see the slide on the Tower Structure for further detail.

In addition, the U.K. business has benefited from R&D tax credits with respect to qualifying R&D expenditure/activity. We understand that HMRC reviewed and agreed with the assumptions used to identify qualifying expenditure.

The planning adopted has had the effect of reducing Target's ETR by approximately 3% annually.

Target has adopted sophisticated transfer pricing methodologies to ensure that material profits are recognized in the U.K. business, as this is where Target's core IP is located.



## Supporting analysis

## Target taxation – FY10 tax provision, ETR, deferred taxes

No financial statements were provided for the U.S. Group (i.e., no U.S. Group specific tax provision, ETR or DTA/DTL breakout).

## Tax provision

Target's financial statements are prepared under IFRS.

The provision for income taxes is based on the U.K. corporate tax rate of 28%. The table presented below represents Target's global tax provision.

Tax provision		
\$'000	2009	2010
Current tax		
Current year	75,147	81,130
Prior year	(2,912)	(7,795)
Subtotal	72,235	73,335
Deferred tax		
Origination and reversal of timing differences	2,280	(8,434)
<b>Total</b>	<b>74,515</b>	<b>64,901</b>

Source: Target Annual Report and Accounts for the year ended 31 December 2010.

## ETR

The ETR reconciled to profit before tax is outlined below and represents Target's global ETR. The ETR as of December 31, 2010 was 23%.

According to management, ETR is managed primarily through transfer pricing policy and the R&D tax credit. Management represented that they forecast the 2011 ETR to be approximately 26%.

Effective tax rate				
\$m	2009		2010	
	%		%	
Profit before tax	266		282	
Tax at UK corporate rate (26%)	75	28.0%	79	28.0%
Tax effect of non-deductible expenses	2	0.7%	1	0.4%
Tax effect of non-taxable income	(1)	-0.5%	(4)	-1.2%
R&D tax credits	(2)	-0.7%	(4)	-1.2%
Utilization of tax losses no previously recognized	(1)	-0.2%	(24)	-8.4%
Other differences	(5)	-1.7%	4	1.5%
Effect of different tax rates	9	3.5%	7	2.3%
Prior year adjustment	(3)	-1.1%	5	1.6%
<b>Tax expense &amp; ETR for the</b>	<b>74</b>	<b>28.0%</b>	<b>65</b>	<b>23.0%</b>

Source: Target Annual Report and Accounts for the year ended 31 December 2010.





## Supporting analysis

## Target taxation – FY10 tax provision, ETR, deferred taxes

The consolidated gross ETR of 23.0% for FY10 was substantially below the U.K. statutory rate of 28%.

This was predominantly due to the utilization of previously unrecognized tax losses, R&D tax credits in the U.K. and U.S. and the tax benefit arising from the Tower Structure.

Management expects an ETR of approximately 26% for 2011 which is in line with the U.K. statutory rate.

The gradual reduction in U.K. tax rates from 26% as of April 1, 2011 to 23% beginning April 1, 2014, is likely to reduce the ETR in future periods.

**FY10** - The consolidated gross ETR of 23.0% for the period is lower than the U.K. statutory rate of 28% predominantly due to:

- The utilization of previously unrecognized brought forward losses (tax effect \$(23.5) million).
- An enhanced deduction with respect to R&D tax credits in the U.K. and U.S. (tax effect \$(3.5) million).
- Tax effect of non-deductible income (tax effect \$(3.5) million). We understand that this predominantly relates to the tax benefits arising from the Tower Structure.

These are partly offset by the following:

- Effect of different tax rates (tax effect \$6.5 million). We assume this arises due to higher U.S. tax rates compared to U.K. tax rates. However, we have not received sufficient information to verify this.
- Tax effect of non-deductible expenditures (tax effect \$1.2 million). We have insufficient information to verify what contributes to this amount.
- Other differences (tax effect \$4.3 million). We have insufficient information to verify what contributes to this amount.
- Prior year adjustment (tax effect \$4.5 million). We do not have sufficient information to verify what contributes to this amount.

**FY09** - The consolidated gross ETR of 28.0% for the period is in line with the statutory rate of 28%.

Given the tax benefit obtained from the Tower Structure and the R&D tax credits, we would have expected the ETR to have been lower than the statutory rate.

Based on the tax reconciliation, it would appear that Target has been adversely effected by higher tax rates in overseas jurisdictions (tax effect \$9.2 million). Given the geographical analysis of Target's turnover, we assumed that the majority

relates to the taxes in the U.S. However, this is not in line with Target's transfer pricing model.

Non-deductible expenditures (tax effect \$1.9 million) also increased the ETR for Target.

The above items were offset against an enhanced deduction with respect to R&D tax credits in the U.K. and U.S. (tax effect \$(1.9) million), and the tax effect of non-deductible income (tax effect \$(1.3) million). We understand that this predominantly relates to the tax benefits arising from the Tower Structure.

Target has also benefited from "other differences" (tax effect \$(4.6) million) and a "prior year adjustment" (tax effect \$(2.9) million).

#### Future ETR

Management represented that they forecast an ETR of approximately 26% for FY11, which is in line with the U.K. statutory rate.

This is based on approximately 80% of profits arising in the U.K. and 20% in the U.S.

It is expected that both the Tower Structure and R&D tax credits will both contribute in reducing the ETR by 1.5% each (total of 3%) for the period.

#### U.K. tax rate

As of April 1, 2011 the U.K. statutory corporation tax rate decreased from 28% to 26%. Furthermore, the rate will continue to decrease by one percentage point annually from April 1, 2012 until it reaches 23% (for the year ended March 31, 2015). At this point only the first reduction from 28% to 26% as from April 1, 2011 and to 25% from April 1, 2012 have been substantively enacted.



## Supporting analysis

## Target taxation – FY10 tax provision, ETR, deferred taxes

Target has a DTL of \$91.1 million which predominantly relates to purchased intangibles.

Target has a DTA of \$16.3 million which primarily relates to future tax deductions on the exercise of share options.

## Deferred taxes

The DTA and DTL balances outlined in the chart represents Target's global balances. The DTA and DTL balances as of December 31, 2010, respectively, was \$16.3 million and \$91.1 million. The U.S. Group specific DTA and DTL balances were not provided.

Deferred tax assets		
\$'000	2009	2010
Tax losses	234	234
Stock option losses	19,362	9,667
Accelerated tax depreciation	4,419	-
Other timing differences	-	6,362
<b>Total</b>	<b>24,015</b>	<b>16,263</b>

Deferred tax liabilities		
\$'000	2009	2010
Purchased intangibles	85,087	84,906
Accelerated tax depreciation	-	6,166
<b>Total</b>	<b>85,087</b>	<b>91,072</b>

Source: Target Annual Report and Accounts for the year ended 31 December 2010.

## DTA

Under IFRS, DTA should only be recognized to the extent that it is probable that taxable profits will be available in the future against which the deductible temporary differences can be utilized.

Management represented that the reported DTA balance is largely related to future tax deductions related to the intrinsic value of the stock options.

The deferred tax asset relates to the following items:

- Stock option losses (\$9.7 million). This relates to the potential tax deductions available on the exercise of stock options currently issued. The DTA does not take into account the situation where the option is not fully vested (i.e. where an option is only one-year through a three-year vesting period only 1/3 of the potential deferred tax asset is recognized). Therefore, if all options vest on a change in control, the tax benefit received by Target could be significantly different from the \$9.7 million.
- Other timing differences (\$6.3 million). We were not provided with sufficient information regarding the nature of these timing differences.
- Tax losses (\$0.2 million).

According to management and the financials, in 2010, Target utilized all of its tax losses and thus, has no unrecognized DTA related to those losses.

## DTL

Management represented that the reported DTL balance is largely related to purchased intangibles where the value of the intangible for book purposes is in excess of the tax basis. As the intangible is amortized, the DTL will reverse over time.

The remaining DTL relates to accelerated tax depreciation which arose as Target receives a tax deduction which is in excess of the depreciation in the financial statements in previous periods.



## Supporting analysis Target taxation - tax reserves

Management booked a \$7 million tax contingency reserve related to its transfer pricing policy.

### Tax reserves

In total, the current tax credit in the accounts as of December 31, 2010 was approximately \$33.2 million.

Management represented that Target has booked a \$7 million tax contingency reserve, representing a reserve for the last four years at approximately 5%. The reserve was set up due to the TP policy employed with respect to the U.S.

Management represented that there is an expectation that the TP policy will eventually be scrutinized under an IRS audit of the U.S. Group with respect to the value driver methodology and residual profit split between the U.K. and U.S.

As we have not been made aware of any other contingencies, we assume that the balance of \$26.2 million relates to actual amounts payable to the revenue authorities.





## Supporting analysis Target taxation – audit history

We were not provided information regarding the recently applicable U.K. Senior Accounting Office rules.

### Target HMRC risk rating

The HMRC issues risk ratings based on the tax profile of U.K. companies based on the historic background, business and activities of the companies. The U.K. parent was initially awarded a high risk rating by HMRC due to the Inspector not understanding the business. However management represented upon further dialogue, the rating was lowered to "low risk."

### U.K. audit history

Management confirmed that there are currently no open inquiries in the U.K. and that no significant adjustments were made with respect to recently closed inquiries into the U.K. R&D claim.

Additionally, Target is subject to the Senior Accounting Officer rules in the U.K. which apply for periods starting on or after January 1, 2010. These rules require the Senior Accounting Officer, typically the CFO, to certify that appropriate tax accounting arrangements have been established and are maintained.

If the Senior Accounting Officer fails to take reasonable steps to ensure that the company has established and maintained appropriate tax accounting arrangements, they could be subject to a personal penalty. Furthermore, this is also likely to result in an increased HMRC's risk grading.

We were not provided with any information to verify the steps taken by Target to satisfy this new requirement.

### U.S. Group audit history

In general, the statute of limitations for federal and most state income tax purposes is three years from the filing of the applicable tax return. However, some states have a four-year statute of limitations. Generally, the U.S. Group's 2008 through current tax filings remain open to IRS and state examination.

Management represented that the U.S. Group is not currently subject to any federal income tax audits. Management further represented that the U.S. Group was last audited "probably three years ago." However, no documentation regarding the nature or conclusion of the last audit cycle was provided.

With respect to state income and non-income taxes, management represented that while many audits are currently ongoing, there have been no significant changes or results from these audits. We have not received any documentation regarding the status or conclusion of any of these audits.





## Supporting analysis

**U.K. transfer pricing - profit split report**

Target has adopted the PSM for transfer pricing. From a U.K. taxing perspective, Target appears to have complied with the requirements for preparation of its study and the risk of HMRC successfully challenging the methodology appears low. The conclusions in the profit split report appear reasonable.

However, there remains a significant risk that IRS could successfully challenge aspects of the analysis. Please refer to the discussion in the U.S. taxation section below regarding transfer pricing.

With respect to the value contribution analysis used to perform the residual profit split, the determination of the percentage value of the parties' respective contributions has been made by management. Depending on the available evidence, there may be a risk that reasonable alternative conclusions as to the parties' respective contributions could be drawn. If sustainable, such alternative conclusions would lead to a different allocation of profit to the parties.

If a transfer pricing adjustment is required, the U.K.-U.S. Double Taxation Convention provides that a disadvantaged taxpayer may seek relief from double taxation by presentation of a case to the taxpayer's competent authority. If necessary, the competent authority shall then endeavour to remedy the double taxation by mutual agreement with the competent authority of the other state.

The mutual agreement procedure may take some time and there is no legal obligation on the competent authorities to reach an agreement, only to endeavour to do so. In our experience U.S.-U.K. competent authority claims are usually resolved, but there may be some delay in this resolution. Even if relief from double taxation is achieved, the adjusted position may still result in increased overall taxation for the group (e.g., due to a tax rate differential and potential interest and penalties).



## Supporting analysis U.K. taxation – compliance

The U.K. tax computations up to FY09 were filed on time and HMRC have until December 31, 2011 to inquire into the FY09 return.

We understand that there are currently no open HMRC inquiries.

### Corporation tax compliance - U.K.

The filing deadline for submission of the U.K. corporation tax returns is 12 months after the end of the relevant accounting period.

Assuming the tax return is filed on or before the statutory filing date, HMRC will have up to twelve months from that date of submission to open an inquiry into the tax return (the "inquiry window").

If no inquiry is opened within the inquiry window the return can be regarded as closed. However, the inquiry window can be extended to four years when "discovery" of new facts is made by HMRC or extended up to 20 years where there has been fraudulent or negligent conduct.

We understand that all corporation tax computations and returns have been submitted on time. The FY10 return needs to be submitted by December 31, 2011.

Therefore, all periods up to FY08 should be closed to "normal" inquiry.

The "normal" inquiry window for FY09 will close on December 31, 2010.

### HMRC inquiries

Management confirmed that there are currently no open inquiries into the U.K. corporation tax returns.

The R&D claims for Target have historically been inquired into, as noted on the previous slide.



## Supporting analysis U.K. taxation – Tower Structure (1)

The tax opinion issued by E&Y appears reasonable, however, we recommend confirming that the structure was implemented as described in the opinion to assess whether there are any potential exposures.

We were not been provided with the Treasury consents and the clearance to pay interest without applying WHT.

### Background

Following the Interwoven transaction in FY09, Target reviewed the funding structure of the U.S. Group.

Management decided to implement a long term financing structure which maintained the characteristics of an equity funding structure.

The Tower Structure was chosen as the overall result reflected an equity equivalent funding structure from a U.K. perspective but had the added benefit of a potential U.S. federal tax deduction for finance costs.

### Summary

The key elements to the structure are the receipt of a U.K. interest deduction for LLC 1 (under Loan B), which is to be group relieved against the interest receipt that AEHL will receive under Loan A. This should result in no net U.K. tax, though importantly, this should only result if the non-trading deficit in LLC 1 can be group relieved.

We understand from a U.S. tax perspective, there is an interest payment by ANAH to AEHL, under Loan A. The interest payment by LLC 1 will be disregarded by ANAH as LLC 1 is treated as a disregarded entity.

A swap has been introduced between LLC 1 and LLC 2 with the intention of ensuring that the group is not exposed to a net foreign exchange position.

The intention is for these transactions to together result in a net interest deduction in the U.S., and a tax neutral position in the U.K.

### U.K. tax issues

The significant U.K. tax issues are considered below. In addition to those issues, in analyzing the structure we have not been provided with the Treasury consents, and the clearance to pay interest without applying WHT.

For these purposes we have assumed that these were all obtained and remain in force.

### Interest deduction

In our experience the key U.K. tax issue is the deductibility of the interest payment made by LLC 1 for tax purposes. Certain U.K. tax rules may prevent a deduction from being claimed on the interest payment.

### Avoidance involving tax arbitrage

The arbitrage rules in Sections 24 and 25 F(No.2)A 2005 can deny a corporation a tax deduction for interest payable on a loan by a company in certain circumstances.

These rules apply where a company is a party to a transaction that forms part of a scheme that contains a hybrid entity, where one of the main purposes of the scheme is to obtain a U.K. tax deduction.

It is possible the tax authorities could argue that LLC 1 comes within these rules unless it shows that the scheme (i.e., this financing structure) was not entered into with a main purpose of obtaining a U.K. tax deduction.

An application was made to HMRC for clearance, whereby HMRC would not seek to apply the rules and deny an interest deduction, on the basis that the scheme/structure was not entered into with a main purpose of obtaining a U.K. tax deduction.





## Supporting analysis U.K. taxation – Tower Structure (2)

The thin capitalization position of LLC 1 will need to be reviewed regularly to ensure that the tax deduction is not denied.

The constitutional documentation of LLC 1 and LLC 2 will need to be reviewed to confirm that these entities are in a group relief group with the other U.K. entities.

We note that clearance has been obtained from HMRC that those rules should not apply to this structure, as there is no U.K. tax advantage.

However, clearance is granted based on the information supplied in the application to HMRC, and so if the structure was implemented in a different manner, the clearance may not be valid.

### Unallowable purpose (Section 441 Corporation Tax Act 2009)

Under Section 441 CTA 2009 (previously Paragraph 13 Schedule 9 FA 1996), where in any accounting period a company is a party to a loan relationship which has an unallowable purpose, relief for any debits and credits (which would otherwise be taken into account) is denied to the extent that is just and reasonable.

Under Section 442 CTA 2009 (previously Paragraph 13(2) Schedule 9 FA 1996), a loan relationship has an "unallowable purpose" if the purposes for which the company is a party to the loan include one which is not amongst its business or other commercial purposes.

It is stated that LLC 1 entered into the loan in order to acquire the Interwoven Group from ANAH. E&Y's conclusion is that this is a prima facie business purpose. Further, E&Y state that where HMRC have granted clearance under the arbitrage rules (as is the case), it is unusual for them to challenge a structure under as an unallowable purpose.

We do not consider E&Y's conclusions unreasonable, but again have not seen all of the documentation surrounding the design and implementation of the structure to ensure that the risk of an unallowable purpose challenge is remote.

### Transfer pricing and thin capitalization

The transfer pricing rules deny a tax deduction for interest payable on a loan where a U.K. resident company is thinly capitalized. Interest may be disallowed because the amount of the loan exceeds the amount a third party would have lent or because the rate of interest exceeds arm's-length terms.

Of concern is Loan B from ANAH to LLC 1. E&Y states: "It is possible that LLC 1 will not have sufficient balance sheet equity in relation to its debt as it is a newly incorporated entity that is likely to have been set up with minimal share capital and prima facie is likely to be considered to be thinly capitalized."

E&Y's opinion provides support for the contention that LLC 1 is not thinly capitalized, however, if its borrowing capacity takes account of the assets that it controls as direct or indirect investments i.e., the Interwoven Group. This would result in assets of approximately \$790 million supporting a debt of \$175 million. Moreover, E&Y state that LLC 1 should have interest cover of 11.29:1.

E&Y's conclusion that LLC 1 is not thinly capitalized and should be able to deduct interest payments, with no restriction, appears reasonable to us.





## Supporting analysis U.K. taxation – Tower Structure (3)

### Treatment of swap

In the absence of the swap, the structure leaves the group with a foreign exchange position that should roughly net off. However, there is a risk that the Disregard Regulations could apply to LLC 1, such that the foreign exchange exposure of LLC 1 under Loan B would be considered to hedge its exposure to exchange movements through true ownership of U.S. subsidiaries. If this were the case, Target would have a net foreign exchange exposure on Loans A and B.

It appears that the intention of entering into a swap with LLC 2, is that LLC 1 largely removes its foreign exchange risk, and reduces the risk of the Disregard Regulations applying. The result is that LLC 2 has the foreign exchange exposure.

The structure is designed so that the exposure of LLC 2 should correspond to and cancel the foreign exchange exposure of AEHL. However, for this to be the case, the two companies must be grouped for foreign exchange purposes.

### Group relief

Even if the interest payment by LLC 1 under Loan B is accepted as deductible (as appears to be the case), it is also necessary that the non-trading debit that this would create in LLC 1 may be surrendered to AEHL to offset against the corresponding interest receipt of AEHL.

Further, for the foreign exchange position of Loans A and B to be largely neutral, LLC 2 will also need to be grouped with AEHL.

For the non-trading deficit and any exchange losses to be relieved, LLC 1, LLC 2 and AEHL must be considered to be part of the same group for U.K. group relief purposes. E&Y's memorandum states that ANAH holds all of the entire share capital of LLC 1 and LLC 2, and AEHL holds the share capital of ANAH. LLC 1 and LLC 2 have issued member's interest certificates to ANAH, which HMRC state they accept as being "ordinary share capital." On this basis, LLC 1 and LLC 2 should fall within the definition of a "75% subsidiary" for group relief purposes.



## Supporting analysis

**U.K. taxation – Research and Development allowances and WHT**

Under U.K. tax rules a large company can claim a deduction equal to 130% of the qualifying R&D costs.

Target incurs a significant amount of qualifying R&D expenditure in the U.K. and due to the size of the claims HMRC has historically inquired into these claims every two to three years.

Management represented no significant adjustments were made as a result of historic inquiries and in each case HMRC agreed with the underlying methodology used to calculate the claim.

**R&D claims****Corporation tax rules**

Under U.K. corporation tax rules a company which undertakes R&D activities and incurs qualifying revenue expenditure (which may potentially be reflected in the statutory accounts under intangible fixed assets) is entitled to an enhanced deduction in calculating its chargeable profits.

A large company can claim a deduction equal to 130% of the qualifying costs (125% for claims made prior to April 1, 2008).

Qualifying R&D expenditures would potentially include staff costs, software, consumables, externally provided workers and subcontracted R&D (both of which are usually restricted to 65% of the costs incurred).

A U.K. company which incurs qualifying capital expenditure relating to R&D activities is entitled to a 100% first year allowance. However, no enhancement is available for capital expenditures.

**Applicability to Target**

We understand Target incurs a significant amount of qualifying R&D expenditure in the U.K.

Due to the size of the claims, HMRC has historically inquired into the claims every two to three years.

Management confirmed that no inquiries are currently open and previous inquiries were closed without any significant adjustments. In each case HMRC agreed with the underlying methodology used to calculate the claim. We understand that Target has not changed the methodology since the last HMRC inquiry.

**Withholding tax on royalty payments**

From our discussions with management, we understand that the majority of the royalty payments are between the EU and the U.K. and the U.S. and the U.K. No withholding tax is applied to these royalties.

Target has experienced some withholding tax issues in Latin America. However, we understand that the amounts involved are insignificant.



## Supporting analysis

**U.K. taxation - Share incentives – U.K. awards (1)**

Target operates two unapproved share plans.

Unapproved share options have been granted to U.K. employees.

Options are exercisable on a change in control.

U.K. PAYE and NIC will be due on the exercise of the unapproved share options on the difference between the value of the shares on exercise and the exercise price.

The rules of the U.K. Plan provide for the transfer of the employer's NIC liability to the employee.

**Background**

Target operates two unapproved share option plans, the U.K. Plan and the 2008 U.S. Share Option Plan.

**U.K. Plan**

The options schedule in the data room provides that there are a total of 9,586,994 active options granted under all of Target's share plans, and of this total, there are 3,275,068 active options granted under the U.K. Plan.

However, while this appears to be the number of active options, the schedule provides that the total number of options deemed to be outstanding under the U.K. Plan is 7,619,244. We have been unable to reconcile these numbers.

Further, share options have been granted under other share plans, and confirmation is required that no such options have been granted to U.K. employees.

In 2010 the Board introduced a new share policy, the Deferred Shares Bonus, under which shares are granted which vest depending on the extent to which the business meets targets over a three year period. The maximum award level for executive directors for 2010 and 2011 is 100% of base salary. Shares will normally be released to participants after the third anniversary of the award. Any ordinary shares granted under this policy will be satisfied from the EBT rather than a new issue of shares.

The accounts also refer to deferred bonuses to executive directors in 2010 being made in the form of share options.

**Impact of change in control**

The unapproved options granted under the U.K. Plan vest over a vesting period, with the initial vesting taking place after six or 12 months and the remainder vesting over a period of 2.5 to 3.5 years.

The rules of the U.K. Plan provide that options become exercisable during the following periods in connection with a change in control (and then lapse on the expiry of the earliest applicable period):

- within six months of a change in control;
- conditionally from the date on which the court orders a shareholders' meeting to sanction a proposed compromise or arrangement until noon on the day immediately preceding the shareholders meeting, or such other period and on such terms as the Board shall determine acting fairly and reasonably; and
- any time during which a person is bound or entitled to acquire the company's shares under sections 428 to 430F Companies Act 1985 (now sections 979 to 982 Companies Act 2006, i.e. the squeeze out provisions once 90% have been offered).

The rules of the U.K. Plan also provide that on a change in control, employees may exchange their options for equivalent options over shares in the acquiring company where the acquiring company consents to such an exchange of options.

**PAYE and NIC**

PAYE and employer's and employee's NIC will be due on the exercise of the unapproved options held by U.K. employees on the difference between the market value of the shares at the date of exercise and the exercise price.





## Supporting analysis

## U.K. taxation - Share incentives – U.K. awards (2)

A statutory corporation tax deduction may be due on the exercise of the unapproved options by U.K. employees.

Target operates an EBT which is used to hold shares to satisfy options. Further information is required with respect to EBT.

The rules of the U.K. Plan provide that in order to exercise their options, the employees must deliver payment for the PAYE liability arising to Target or enter into arrangements satisfactory to Target for the satisfaction of the tax liability. Further, unless the Board determines otherwise at the date of grant, the PAYE liability includes the employer's NIC liability. Where the employer's NIC liability has been transferred to the employee, this will be an employee cost as well as the employee's NIC. Target must withhold these amounts and account for them to HMRC.

It is necessary to obtain confirmation that the employer's NIC liability has been transferred to the employees with respect to all existing share options.

#### Corporation tax deduction

A statutory corporation tax deduction may be available under Part 12, CTA 2009 on the exercise of the unapproved share options provided that the relevant conditions of the legislation are met.

The main conditions for the relief on the exercise of options are that:

- The shares are ordinary share capital, fully paid up and not redeemable;
- The shares are in a company not under the control of another company, unless that company is listed on a recognized stock exchange;
- The grant must be for the purpose of the business of the employing company, which must be within the charge to U.K. corporation tax;
- Shares acquired must be shares in the employing company or a company which at the time of the grant is a parent company of the employing company; and
- The employee is subject to U.K. income tax on the shares (or would be if he were both resident and ordinarily resident in the U.K. and carried out his employment duties in the U.K.).

The purchaser is listed on a recognized stock exchange, and therefore the exercise of the options should qualify for a corporation tax deduction both pre and post change in control, assuming the other conditions are met.

#### EBT

According to documents provided, Target operates an EBT which is used to satisfy share options granted to U.K. employees. On December 31, 2010, the EBT held 389,699 shares. We have not been provided with any further details in respect of the EBT but note the comment above about the Deferred Shares Bonus awards being satisfied using EBT shares. These shares could therefore be fully allocated to that arrangement or there could be surplus EBT shares which could be used to satisfy some of the outstanding options under the U.K. Plan.





## Supporting analysis U.S. transfer pricing

Based on our high-level calculations with limited data, we believe there is a potential taxable income exposure of approximately \$50 million to \$75 million for the four acquisitions previously cited through the extension of the life of the U.S. IP.

### Legacy transfer pricing

Between 2005 and 2009, Target made several acquisitions. For the purpose of this report, we will discuss only four acquisitions, those of the following U.S. companies:

- eTalk;
- Verity Cardiff;
- Zantaz; and
- Interwoven.

The acquired companies had developed technology IP, strategic business know-how, customer relationships, and business reputation/brand image. Target also developed similar IPs and subsequent to the acquisitions, Target combined its own IP with those of the acquired entities. The combined IP was used to develop "post-acquisition" products.

As a result of combining the IPs specifically:

- (i) ownership of valuable product R&D;
- (ii) access to strategic business know-how;
- (iii) access to new customers; and
- (iv) business reputation/ brand image, the U.S. Group made a payment to the U.K. parent in the form of a royalty for Target's share of the contributed IPs, which was calculated using the PSM. The royalty was calculated using sales as the base.

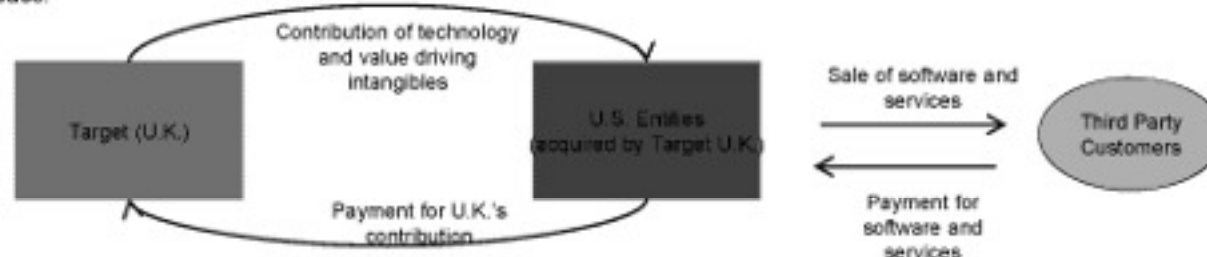
As outlined in the U.K. transfer pricing section, the RPM was applied as follows:

- The U.S. Group was paid a routine return of 3.5% OM on sales. The 3.5% margin was determined based on a benchmarking analysis using the Comparable Profits Method, which generated an inter-quartile range of 1.39% to 3.5%.
- The remaining profit (referred to as "super-profits") earned by each U.S. company was split between the U.K. parent and the U.S. company based on the U.K. parent's and the U.S. entity's contribution of IP. The weight of the IPs contributed by the U.S. Group versus the U.K. parent was developed through discussions with management from both the U.S. Group and the U.K. parent.

To arrive at the contribution split, a weight was first assigned to each of the value drivers:

- (i) ownership of valuable product R&D;
- (ii) access to strategic business know-how;
- (iii) access to new customers; and
- (iv) business reputation/ brand image.

The value drivers were split between U.S. and U.K. for each year over a five year period.





## Supporting analysis U.S. transfer pricing

- Then the percentages for each value driver was summed to arrive at a total IP contribution split for the U.S. entity and the U.K. parent. The total weight was then applied to split the residual profit for each year. The amount attributable to the U.K. parent was paid by the U.S. entity to the U.K. parent as a royalty.
- This analysis was done over a five-year period and in each of the years, the value drivers were shifted in favor of the newly developed IPs and away from the U.S. entities' IPs such that the weight of the newly developed IPs' contribution comprised of the majority of the weight at the end of the five year period.

In applying the RPM, there are several areas of uncertainties from a U.S. tax perspective:

- We note that the "super profits" were divided between U.K. and U.S. entities based on a qualitative analysis of four value drivers, discussed above. Even though weights were assigned to each of the drivers and the weights were then split between U.K. and U.S. entities, a clear rationale was not provided in the memo for allocating X% to one entity and Y% to another. The IRS could question the profit allocation that is based solely on discussions with management.
- The application of RPM results in what would appear to be a one-way royalty from the U.S. to the U.K. It is not clear whether the RPM model used in the transfer pricing memo takes into consideration a situation where the combined IP of the U.S. Group and the U.K. Parent were exploited by Target in selling products in the non-U.S. market. In the event the U.K. parent also makes a sale, then a routine distribution return would be given to the U.K. parent and accordingly, Target would make a royalty payment to the U.S. Group for their IP contribution.

- The value drivers were gradually shifted in favor of the newly developed IPs and away from the IP developed by the U.S. Group over a period of five years. It is not clear why the value drivers were shifted within a period of five years, indicating that the life of the IP owned by the U.S. Group was only five years. The IRS could contend that the life of the IP was longer than five years, potentially extending the period to ten years.

The IRS may extend the life of the IP developed by the U.S. Group and argue that the royalty payable by the U.S. Group to Target in the first five years was much lower than that calculated in the transfer pricing memo. Based on our high-level calculations with limited data, we believe there is a potential taxable income exposure of approximately \$50 million to \$75 million for the four acquisitions previously cited through the extension of the life of the U.S. IP.

Even under the existing transfer pricing methodology, it would be important for Target to compare the forecasted financials used in the RPM with the final financial statements of the U.S. Group to analyze the potential profit or loss earned by the U.S. Group. Further, in the event the U.S. Group is earning losses, it would be relevant to analyze whether Target would share in these losses.

There is a potential that the IRS could apply other methods of calculating the value of IP owned by the U.S. Group, which was eventually combined with that of the U.K. Possible methods are the Income Method, Market Capitalization, and the Acquisition Price Method. Since there was limited data, we could not calculate the potential exposure with respect to the value of IP transferred by the U.S. to U.K. under these methods.

To the extent the IRS makes an adjustment to the profitability of the U.S. Group, there would be potential for competent authority involvement.



## Supporting analysis U.S. taxation - current tax profile

We have not been provided with any U.S. federal income tax returns during the course of our diligence.

### Federal filings

We have not been provided with any U.S. federal income tax returns during the course of our diligence.

Based on discussions with management and the provided organizational chart, ANAH is the parent of the U.S. federal consolidated group and files on the behalf of all U.S. entities. Based on Target financials, the U.S. Group likely has a December 31 year end and files on a calendar year basis. As the common parent of the U.S. Group, ANAH would file Form 1120 *U.S. Consolidated Corporation Income Tax Return* annually.

### Tax attributes

Based on the information provided and discussions with management, we understand that there are a number of important tax attributes that should carryover in the proposed acquisition of Target.

- **NOLs** - the U.S. Group has had a number of losses that have been self-generated as well as acquired. However, based on provided IRC section 382 studies and third party reviews of these IRC section 382 studies, use of the acquired losses have been limited.
- **R&D tax credit** - Management represented that the R&D tax credit plays a key role in managing the ETR for the U.S. Group. However, management also represented that Target's R&D is primarily conducted in the U.K. For U.S. federal income tax purposes, R&D expenditures in these foreign jurisdictions would not be included in the U.S. R&D tax credit calculation.

- **Other attributes** - We have not been apprised of any other attributes. They will be considered when further data is provided.





## Supporting analysis

## U.S. taxation – net operating losses

The U.S. Group has historically both self-generated as well as acquired NOLs. Based on documents provided, both acquired and generated NOLs were subject to IRC section 382 limitations on utilization.

We are unable to validate management's representations that the majority of losses were to be fully utilized by 2011 based on the information provided.

## Net operating losses, generally

The U.S. Group has both generated and acquired losses since 1996. Based on a third party review of Target's IRC section 382 limitations, as of the year ended December 31, 2009, the U.S. Group had acquired or generated NOL carryovers of approximately \$389.8 million. The report also indicated that approximately \$75.8 million of the NOLs were to be subject to permanent limitation by reason of IRC section 382, and thus are to expire unutilized. Management represented that all available losses were substantially utilized in 2010 and prior years, and any remaining residual losses were to be utilized by 2011. However, based on the documents provided, we were unable to confirm these representations. Please see the summary of PwC-revised NOLs and limitations on the following pages.

Generally, in a stock acquisition, the target company retains its historical U.S. tax attributes; however, some of these attributes are subject to an annual limitation. IRC sections 382 and 383 impose limitations on a corporation's ability to use its NOL and credit carryforwards (and certain other tax attributes), following an "ownership change." States generally impose similar limitations following an "ownership change."

An "ownership change" is a cumulative increase by "5% shareholders" of more than 50 percentage points (by value), within a rolling three-year period. Such a change in the equity of a company having tax attributes will generally cause an ownership change for purposes of IRC section 382 and results in the application of an annual limitation on the utilization of NOLs, credits and certain other tax attributes subsequent to the ownership change.

The annual limitation is generally calculated by multiplying the long-term tax exempt rate in effect at the time of the ownership change (e.g. 4.17% for ownership changes in August 2011, see Rev. Rul. 2011-16) by the fair market value of the loss company's equity on the ownership change date. The fair market value of the shares must be adjusted for various special rules under IRC section 382. Under IRS Notice 2003-65, the annual limitation may generally be increased by the additional hypothetical depreciation/amortization that would have been generated had an asset purchase occurred upon the ownership change date. The annual limitation may also be increased by any additional built-in gain recognized within the initial five years after the acquisition. All such increases to the limitations are limited to the NUBIG at the date of the ownership change.

Alternatively, if the target corporation has a NUBIL immediately prior to the ownership change date, any portion of such NUBIL recognized during the five-year recognition period is subject to the annual limitation. Such recognized built-in losses can include depreciation and amortization with respect to built-in loss assets.





## Supporting analysis

**U.S. taxation – net operating losses****Net operating losses, documents provided**

The U.S. Group has conducted a number of IRC section 382 limitation studies on its self-generated and acquired NOLs (through the Zantaz acquisition). Specifically, IRC section 382 studies were conducted on ANAH, Target, Inc., Verity, and Zantaz. We were provided a review of these IRC section 382 studies, conducted by the U.S. Group's external tax advisor, PwC. In addition, PwC also conducted IRC section 382 studies on the Virage and Interwoven acquisitions.

The PwC review of the U.S. Group's IRC section 382 studies makes several observations about the initial starting testing dates of some of the studies, conclusions reached about presumed 5% and non-5% shareholders and their effects on whether an ownership change occurred on the specified dates and subsequently, conclusions reached about the level of limitation on the ownership change dates.

- PwC found in certain cases, initial testing dates were incorrect.
- PwC questioned the inclusion of certain 5% shareholders which affected the calculation of the ownership date.
- PwC applied Notice 2003-65 to increase the limitations.

Based on these findings, PwC substantially revised the IRC section 382 studies and limitation calculations. Please see the next page for a summary of revised ownership dates and calculated limitations.

The PwC review did not include adequate equity rollforward documentation, thus, we were unable to attempt to corroborate the findings of the PwC review. However, with respect to the procedures and assumptions used to review the U.S. Group IRC section 382 studies, we find the approach and general application of the IRC section 382 rules (i.e., cash issuance exception, small issuance exception, 5% shareholder vs. investment adviser presumptions, etc.) to be reasonable.

With respect to the PwC studies of Virage and Interwoven, we similarly find that the procedures and assumptions used and general application of the IRC section 382 rules to be reasonable.

**Net operating losses, previously unutilized**

Management represented that approximately \$23.5 million of losses previously unutilized were recognized in 2010. Management represented that these losses were related to Interwoven and that there were doubts as to whether or not the losses could be utilized. While management represented that a recent IRC section 382 study confirmed appropriate use of the losses, it is not immediately clear which losses were disputed and how management confirmed the use of the losses based on material provided.



## Supporting analysis U.S. taxation – net operating losses

Based on the PwC review and revisions of the U.S. Group IRC section 382 limitations, the U.S. Group had generated or acquired approximately \$389.8 million NOL carryovers, \$75.8 million of which in future years will expire before being utilized.

### Ownership changes & section 382 Limitations (per PwC review and studies)

Entity	Ownership change dates	Section 382 limitation	Notice 2003-65 NUBIG	Total limitation	NOL C/F subj. to 382 analysis	NOLs permanently limited
ANAH	none	-	-	-	1,206,387	
Autonomy, Inc.	July 15, 1998	1,525,589	2,371,571	3,897,160		
	December 31, 2000	98,433,107	122,315,341	220,748,448	66,784,112	-
	December 19, 2005	13,731,437	20,935,009	34,666,446		
Verity, Inc.	February 17, 1998	2,765,105	-	2,765,105		
	September 3, 2005	10,706,877	3,256,055	13,962,932	62,044,530	-
	December 31, 2005	21,302,457	-	21,302,457		
Zantaz, Inc.	May 1, 1998	3,322	-	3,322		
	June 23, 1998	4,212	-	4,212		
	October 8, 1999	2,102,883	-	2,102,883	(1)	75,975,745
	August 18, 2004	3,926,298	6,215,226	10,141,524		1,361,242
	July 20, 2007	15,925,867	21,580,322	37,506,189		
Virage, Inc.	April 3, 1995	12,482	192,085	204,567		
	April 27, 1998	164,986	535,868	700,854		
	December 17, 1998	2,500,606	2,963,688	5,464,294		
	February 14, 2002	-	-	-	(2)	88,834,814
	July 9, 2003	541,602	625,759	1,167,361		71,213,109
	September 2, 2003	570,734	633,506	1,204,240		(4)
	December 19, 2005	-	-	-	(3)	
Interwoven	April 1, 1996	770	-	770		
	May 9, 1997	3,821	139,250	143,071		
	March 31, 1998	2,346	227,849	230,195		
	December 31, 1999	153,943,915	180,434,345	334,378,260	94,965,070	3,198,002
	December 29, 2002	5,609,956	-	5,609,956		(5)
	March 27, 2009	41,749,276	18,724,827	60,474,103		
<b>Total</b>					<b>389,810,658</b>	<b>75,772,353</b>

Note: (1) Mistakenly transcribed as August in summary NOL schedules. The accompanying memo notes ownership change date as October.

(2) \$62 million in capital contributions removed per anti-stuffing rules, thus limitation is \$0.

(3) Value of Virage increased dramatically, between 2003 to December 2005, the IRC section 382 limitation on this ownership change date was determined to be generally irrelevant by PwC.

(4) The accompanying memo cites the NOLs lost to expiration as \$59 million. The Virage work papers indicate \$71.2 million.

(5) The calculation of NOLs permanently limited by the IRC section 382 limitation is overstated by approximately \$650,000. The calculation does not account for the prior year permanently limited amount from what is a cumulative account of NOLs subject to the IRC section 382 limitation in the following year.

Source: PwC Review.



## Supporting analysis U.S. taxation – Tower Structure

Target implemented the Tower financing structure to finance its U.S. acquisitions. Key areas of concern are the ability of the U.S. Group to continue to service intercompany debt and not become too thinly capitalized which could unfavorably recharacterize intercompany debt as equity under IRC section 385. The affirmative conclusions of the tax opinion obtained by Target addressing these and other issues appear reasonable.

### Tower structure

Management has represented that it implemented a tax – favorable financing structure, the “Tower Structure,” to finance its U.S. acquisitions, while also repatriating earnings from the U.S. by increasing the level of debt funding provided to the U.S. Group. Management represented that the Zantaz acquisition was the first acquisition financed in such a manner, however, we were only provided with the U.S. and U.K. opinions regarding the structure as it relates to the Interwoven acquisition.

Generally, based on the provided tax opinions, through the use of a U.S. organized/U.K. resident entity (i.e., treated as a corporation for U.K. tax purposes, but a disregarded entity for U.S. federal tax purposes), the Tower Structure allows for ANAH to recognize U.S. deductions for interest paid, yet allows for AEHL interest income to be offset by an interest expense incurred by the U.S. organized/U.K. resident entity. Please see Appendix 4 for the implemented steps, and a schematic of the transaction with key tax concerns typically identified when using these type of structures.

Management represented that currently the U.S. has outstanding intercompany debt of approximately \$470 million. The CFO approximates that Target has received approximately \$15 million in tax benefits from the implementation.

The U.S. tax opinion reached the following conclusions regarding the following U.S. tax issues identified in the Tower Structure as implemented:

- Debt v. equity: the proper characterization of the loan from AEHL to ANAH (“Loan A”) should be debt for U.S. federal tax purposes;
- Deductibility of interest payments: Interest payments made on Loan A by ANAH should be deductible when paid and potentially limited by IRC section 163(j);

- Reduced rate on withholding taxes: AEHL is a beneficial owner of interest payments received from ANAH on Loan A pursuant to the U.S.-U.K. Treaty and thus, no U.S. withholding tax on the interest payments received by AEHL from ANAH should apply;
- Entity classification: LLC 1 and LLC 2 should be treated as single member LLCs, disregarded for U.S. federal income tax purposes;
- Dual consolidated losses: the dual consolidated loss rules do not apply to limit or disallow the deduction of interest payments made by ANAH to AEHL;
- Reportable transaction: the transaction is not treated as a reportable transaction requiring disclosure.

Based on our reading of the U.S. tax opinion, which addresses potential tax issues with respect to the Tower Structure, we find the conclusions of the tax opinion reasonable.

### Debt-equity characterization

Typically, one of the general concerns regarding the use of Tower Structure is the ability of the U.S. entity to service debt and not run afoul of IRC section 385. IRC section 385(b) outlines several factors taken into account to classify payments between two entities as either debt or equity. Such a classification of such advances for U.S. tax purposes (either as debt or equity) is important because it determines whether the U.S. Group can claim interest deductions for payments made with respect to any advances.

The five factors outlined in IRC section 385(b) are: (1) whether the advance is formalized as a loan; (2) whether there is a subordination to or preference over any indebtedness of the corporation; (3) the ratio of debt to equity of a corporation;





## Supporting analysis U.S. taxation – Tower Structure

(4) whether there is convertibility into the stock of the corporation; and (5) the relationship between holdings of stock in the corporation and holdings of the interest in question. However, a debt-equity analysis is not limited to the factors listed in IRC section 385, and a thorough analysis depends on a number of other factors outlined by the courts to determine the economic reality.

### IRC section 163(j) earnings stripping

Generally, IRC section 163(j) limits the deductibility of interest paid or accrued by a U.S. corporation if the debt is borrowed from or guaranteed by a related non-U.S. party. IRC section 163(j) applies if the U.S. corporation's debt-to-equity ratio (as of the end of the taxable year) exceeds 1.5:1. Therefore, the earnings stripping provisions of IRC section 163(j) apply to corporations that are relatively thinly capitalized. Assuming a corporation's debt exceeds the 1.5:1 ratio test as of the end of its taxable year, IRC section 163(j) would prohibit the U.S. Group from deducting interest due on debt guaranteed by a related non-U.S. party, to the extent that the total interest deduction (including interest due unrelated persons) would otherwise exceed 50% of the corporation's "adjusted taxable income" as defined by IRS regulations. Interest in excess of this 50% limit ("excess interest expense") can be carried forward indefinitely.

In this case, based on the tax opinions provided, it does not appear that IRC section 163(j) caused a limitation on the U.S. Group's interest deduction prior to 2010. However, this limitation is tested annually, and continued unbounded use of the Tower financing structure through ANAH could eventually limit ANAH's interest deduction in future years.



# Appendices



## Appendix 1 SOW procedures

Procedures that could not be performed appear in bold.

### Procedures that could not be performed appear in bold.

Unless otherwise noted, our work will concentrate on the last two fiscal years and the most recent available year-to-date financial information, together with Target's forecast for the remainder of FY2011.

Our comments will depend on the extent to which we can carry out the procedures below, the level of information made available, and the level of access we have to Target management. We anticipate that fieldwork may also be performed in U.K. depending on where financial information is located.

### *Financial due diligence assistance – general*

1. Attend management presentations offered by Target.
2. Read information provided in the data room.
3. Participate in interviews of Target management who can address matters you have indicated are of concern to you.
4. Read Target's financial statements and inquire about Target's accounting policies and practices, including:
  - Reporting methodology and consistency with HP's policies and procedures;
  - Differences between U.S. GAAP and IFRS;
  - Basis for cost allocations;
  - Significant accounting policies and estimates, including revenue recognition;
  - Recent or contemplated changes in accounting principles, procedures, or estimates;
  - Intercompany accounts and related party transactions; and
  - Internal control environment including controls at foreign subsidiaries

5. Read Target's auditors' work papers, management letter, and reports to the audit committee for the most recently completed audit and quarterly reviews for this fiscal year.

### *Financial due diligence assistance – Revenues and revenue recognition; expenses*

6. Obtain and read materials outlining Target's historical revenues and inquire about:
  - Revenue recognition policies and procedures;
  - Target's methodology for establishing fair value for undelivered elements in multiple-element transactions;
  - Revenue composition (e.g., license, professional services, hosting, maintenance) by significant products/offerings;
  - Historical trends in revenue and key metrics including customers (direct, OEM, resellers), products, geography, sales channel, customer type, new vs. existing customers, renewal rates, attrition, volumes and pricing;
  - Target's pricing model (including implementation) and professional services;
  - Discounts and allowances;
  - Revenue vs. cash collection;
  - Acquisition vs. organic growth;
  - Seasonality;
  - Foreign exchange;
  - Deferred revenue and the expected timing of revenue recognition;
  - Non recurring revenue, including discontinued offerings and one-time items;
  - Cut-off; and
  - Order backlog, historical conversion rates and pipeline.



## Appendix 1 SOW procedures

Procedures that could not be performed appear in bold.

7. At your request, read the financial terms of the 20 largest customer contracts and 20 largest partner and VAR contracts by value in each of 2010 and 2011 and comment on standard and non-standard contract terms and issues having a potential revenue recognition impact.
8. Hold discussions with you and your internal accounting team to discuss our findings with respect to Target's revenue recognition. Assist your team in considering the post-close implications, if any, on your own revenue recognition.
9. Summarize the potential identified adjustments regarding the profit and loss performance of Target in the form of a quality of earnings analysis, summarizing the risks that may impact earnings.
10. Obtain and read an analysis of Target's expenses and inquire about:
  - Historical trends in costs and key cost metrics, gross margins and operating margins;
  - Cost of revenues;
  - Royalty costs and license fees to support intellectual property;
  - Capitalized costs including commissions and software development expenses
  - Overhead;
  - Consulting labor costs (including billing and utilization rates) and the extent to which subcontractors are utilized to perform consulting services;
  - Selling, general, and administrative expenses;
  - Research and development;
  - Trends in key metrics, including headcount and average salaries;

- Fixed salaries, profit sharing, commissions and bonuses;
- Restructuring charges;
- Unusual and extraordinary items; and
- Cut-off.

### *Financial due diligence assistance – Balance sheet, working capital, cash flow*

11. Obtain and read an analysis of Target's accounts receivable and inquire about:
  - Credit terms;
  - Aging analysis;
  - Trade and non-trade balances; and
  - Allowance for uncollectible accounts and write-offs.
12. Obtain and read an analysis of Target's fixed assets, capital expenditures, and other significant assets and inquire about:
  - Equity and other investments;
  - The components of other assets and intangible assets;
  - Historical, deferred, and planned capital expenditures; and
  - Impairment write-downs and issues.
13. Obtain and read an analysis of Target's accounts payable, accrued liabilities, deferred revenue, and other significant liabilities and inquire about:
  - Accounts payable and accrued liabilities;
  - Restructuring provisions;
  - Deferred revenue and the timing of future revenue recognitions; and
  - Other current and non-current liabilities.



## Appendix 1 SOW procedures

Procedures that could not be performed appear in bold.

### 14. Inquire into Target's banking relationships, including its:

- Outstanding indebtedness;
- Banking agreements;
- Change in control and repayment penalties
- Borrowing terms and debt covenants; and
- Credit facilities.

### 15. Obtain and read an analysis of Target's historical cash flows and working capital and comment on historical working capital and cash flow trends and cash flows by entity.

#### **Financial due diligence assistance – Commitments and contingencies**

16. In conjunction with your attorneys, inquire about significant commitments and contingent liabilities including:
- Customer commitments (specified technology, support commitments, etc.);
  - Pending or threatened litigation or investigations by regulatory or other authorities;
  - Commitments related to historical and pending acquisitions;
  - Self-insurance;
  - Post-retirement benefits and pension arrangements;
  - Warranty obligations;
  - Incentive compensation; and
  - Committed or contractual capital expenditures.
17. In conjunction with your attorneys, inquire about change-in-control provisions in significant contracts, including employment contracts; supply agreements; debt agreements; and option, warrant, stockholder, preferred stock, and other equity-related agreements.

#### **Financial due diligence assistance – Internal control infrastructure**

18. Hold a discussion with Target's independent accountants about their approach to testing and relying on Target's internal control infrastructure as part of their financial statement audits.

#### **Management's forecasts/projections**

19. Obtain historical and latest interim financial information available and compare actual results to budget. Interview management about the reasons for significant fluctuations between periods and with budget.
20. Based on the results of our other procedures comment on key financial, accounting and tax issues that may have an impact on your valuation model.

#### **Financial due diligence assistance – Preliminary (indicative) purchase price**

21. Read Target's public filings, interview Target management, and read Target management's financial projections to assist in a preliminary (indicative) "top-level" purchase price allocation for the purpose of providing inputs to your financial model regarding deferred revenue and key intangible assets prior to announcing the potential transaction.

#### **Tax due diligence – U.S.**

22. Hold a discussion with Target's tax director, CFO, CEO, and/or tax preparers and advisors to and discuss significant tax issues.
23. Obtain details of and inquire about Target's legal and tax structure.
24. Obtain and read tax returns for recent open tax years and inquire about historical positions taken with respect to state (including income, sales/use, property, payroll, etc.) and federal tax issues.
25. Inquire about and comment on tax sharing agreements, if any.





## Appendix 1 SOW procedures

Procedures that could not be performed appear in bold.

26. Inquire about structuring of significant transactions in open tax years (including acquisitions, dispositions, joint ventures, and intercompany transactions) and the tax treatment thereof.
27. **Inquire about historical positions taken and compliance with respect to significant sales and use, property, payroll, unclaimed property, gross receipts, and employment.**
28. Obtain and read a summary of the components of current and deferred tax accounts and reserve analyses (including tax reserve analyses), and inquire about historical positions taken.
29. Inquire about completed and ongoing tax examinations, administrative proceedings, or tax litigation, **and comment on the potential resulting cash flow and financial statement implications with respect to future open years.**
30. Inquire and discuss with Target personnel (and tax advisors if appropriate) about tax attributes, including net operating loss and credit carryforwards. Inquire about limitations on the use of the tax attributes.
31. Inquire about the established processes and internal controls around the tax process.
32. Inquire about international affiliates and services provided outside the U.S., as well as Target's transfer pricing.
33. Inquire about IRC section 409A compliance (deferred compensation arrangements).
34. **In conjunction with your attorneys, inquire about change-in-control provisions, in employment contracts including IRC section 280G exposure, to assess severity of exposures to golden parachute payments or issues. Our work does not include preparation of the final calculations of the actual disallowed deduction or the specific amount of excise tax due once (and if) the transaction is consummated. Our work also does not include assistance with developing, designing or implementing steps to mitigate potential IRC section 280G exposures. We recommend that you engage a benefits consulting firm to provide any services that are beyond the scope of this engagement.**

### *Tax due diligence – U.K.*

35. Read tax returns prepared for the relevant period and inquire about potential tax implications and exposures.
36. With regard to corporate tax matters:
  - Obtain and read corporate income tax returns and underlying working papers for open tax years and understand historical positions taken with respect to such tax returns.
  - Understand structuring of significant transactions in open tax years (including acquisitions, dispositions, joint ventures, and intercompany transactions) and the tax treatment thereof.
  - Read reports issued regarding completed and ongoing tax examinations, administrative proceedings, or tax litigation, and consider the resulting cash flow and financial statement implications with respect to future open years.
  - Comment on the corporate tax provision in the statutory accounts. In addition, obtain and read a summary of the components of current and deferred tax accounts and reserve analyses, as well as understand significant historical positions taken.
  - Comment on the effective tax rate and reconcile to the relevant statutory tax rates.
  - Summarize details of identified significant tax attributes such as trading and capital losses and comment on their availability for use in future periods including restrictions arising on a change of ownership or time limitations for future use.
  - Inquire about tax planning or optimization strategies which have been undertaken including copies of clearance applications submitted and the responses from the tax authorities.



## Appendix 1 SOW procedures

Procedures that could not be performed appear in bold.

### 37. With regard to employee taxes:

- **Inquire about whether Target has been subject to a recent wage/payroll audit and, if so summarize the results identified.**
- **Discuss with management whether Target has submitted payroll tax/social security returns within the statutory time limits and whether payroll/social security remittances have been made to date.**
- **Summarize identified potential payroll and/or social security issues relating to the engagement of self employed contractors.**
- **Read rules of share incentive plans and summarize the identified potential impact of the transaction on such plans, specifically in terms of the payroll and social security exposures for employing companies on vesting and lapsing of awards.**

### 38. With regard to value added taxes:

- **Obtain details of VAT registration status and discuss with Management whether registration obligations have been complied with.**
- **Discuss with Management whether Target has complied with its VAT/sales tax accounting obligations, and comment on identified areas of non-compliance**
- **Discuss with Management whether any Revenue authority has conducted inspections or made inquiries into Target's VAT/sales tax affairs during the last three years and comment on the outcome.**

### 39. With regard to transfer taxes:

- **Comment on significant transfer taxes or capital taxes which may be payable on the sale/purchase of the companies.**

### 37. Obtain and read intercompany agreements (i.e. transfer pricing analysis).

- 38. Inquire about location of significant intellectual property including inquiry into: (1) any IP migration structures and buy-in/out arrangements, including territories covered and royalty payment terms; and (2) cost sharing arrangements, including whether stock option compensation was included in the cost sharing pool, when required.

### *Financial due diligence assistant - Deal structuring and financial reporting*

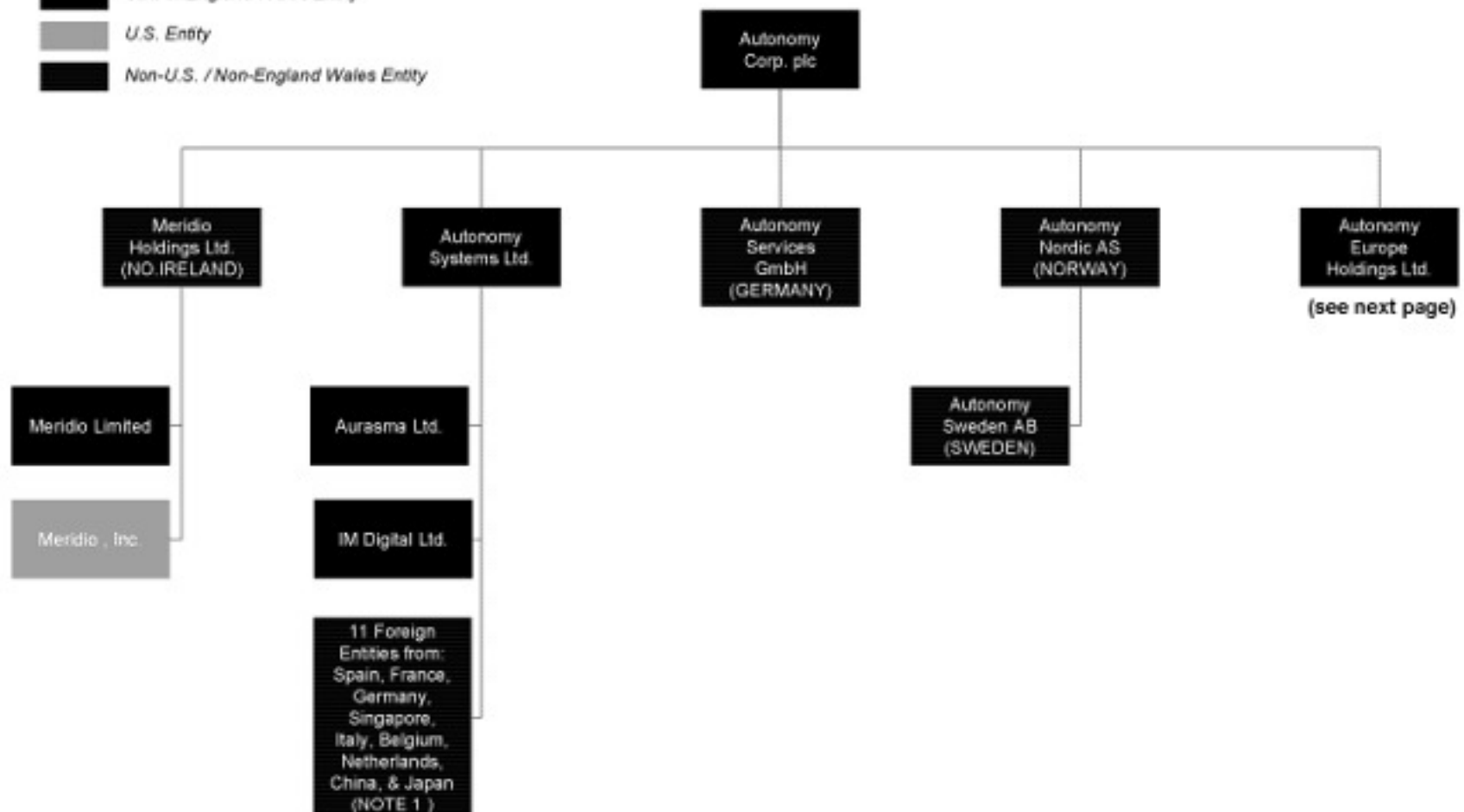
- 42. **Read the latest available draft of the purchase and sale Agreement and offer commentary to you and your attorneys primarily concerning sections relating to accounting and tax matters, based on the results of the due diligence assistance we provided. You agree to review with your attorney all our comments and suggestions concerning the purchase and sale agreement before acting on any of our suggestions.**
- 43. **Meet with you and your advisors to discuss possible accounting and tax structuring alternatives relating to matters you and your advisors have identified.**
- 44. **Meet with you and your advisors to discuss SEC reporting requirements and assistance with financial reporting.**



## Appendix 2 Organizational chart (1)

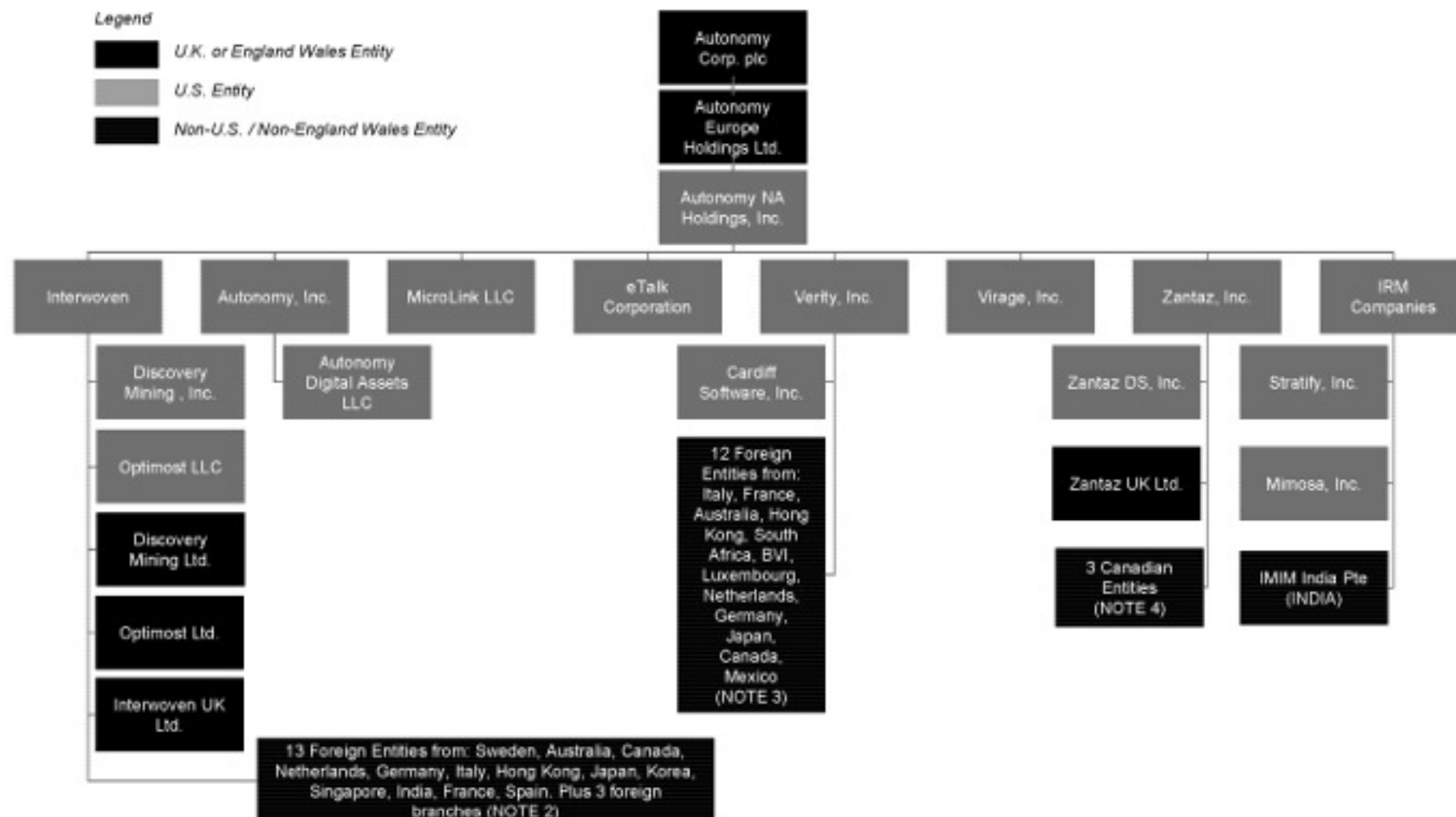
### Legend

- U.K. or England Wales Entity
- U.S. Entity
- Non-U.S. / Non-England Wales Entity





## Appendix 2 Organizational chart (2)







## Appendix 2

## Organizational chart (NOTES) (3)

## NOTES:

- (1) The 11 foreign entities not shown under Autonomy Systems Limited are:

Autonomy Spain SL (SPAIN)  
 Autonomy France Sarl (FRANCE)  
 Autonomy Germany GmbH (GERMANY)  
 Autonomy Systems Singapore Pte Ltd. (SINGAPORE)  
 IM Digital Sarl (FRANCE)  
 Autonomy Italy Srl (ITALY)  
 Autonomy Belgium BVBA (BELGIUM)  
 Autonomy Netherlands BV (NETHERLANDS)  
 Autonomy Systems (Beijing) Ltd. Co. (BEIJING)  
 IM Digital KK (JAPAN)  
 IM Digital GmbH (GERMANY)

- (2) The 13 foreign entities not shown under Interwoven are:

Interwoven AB (SWEDEN)  
 Interwoven Canada Ltd. (CANADA)  
 Interwoven GmbH (GERMANY)  
 Interwoven Hong Kong Ltd. (HONG KONG)  
 Interwoven Korea, Inc. (KOREA)  
 Interwoven Software Services India Pvt Ltd. (INDIA)  
 Interwoven SAS (FRANCE)  
 Interwoven Australia Pty Ltd. (AUSTRALIA)  
 Interwoven BV (NETHERLANDS)  
 Interwoven Srl (ITALY)  
 Interwoven Japan KK (JAPAN)  
 Interwoven Software Pte Ltd. (SINGAPORE)  
 Interwoven Software SL (SPAIN)

**The 3 branches not shown under Interwoven are:**

Mumbai  
 PRC  
 Taiwan

- (3) The 12 foreign entities not shown under Verity, Inc. are:

Verity Italy Srl (ITALY)  
 Autonomy Systems Australia Pty Ltd. (AUSTRALIA)  
 Autonomy Systems South Africa (SOUTH AFRICA)  
 Autonomy Systems Canada Ltd. (CANADA)  
 Verity Mexico S. de R.L.de C.V. (MEXICO)  
 Verity France Sarl (FRANCE)  
 Verity Hong Kong Ltd. (HONG KONG)  
 Autonomy Japan KK (JAPAN)  
 Verity BVI (BRITISH VIRGIN ISLANDS)  
     owns Verity Luxembourg Sarl (LUXEMBOURG)  
     owns Verity Benelux BV (NETHERLANDS)  
     Verity Deutschland GmbH (GERMANY)

- (4) The 3 Canadian entities not shown under Zantaz, Inc. are:

3086025 Nova Scotia Co. (CANADA)  
 2040523 Ontario, Inc. (CANADA)  
 Zantaz Canada, Inc. (CANADA)

- (5) Other DORMANT entities listed on Target Organizational Chart:

Dremedia Ltd. (UK)  
 Neurodynamics Ltd. (UK)  
 Nholdings Ltd. (UK)  
 Ncorp Ltd. (UK)  
 Softsound Ltd. (UK)  
 Virage Europe Ltd. (UK)  
 Longsand Ltd. (UK)  
 Meridio Management Ltd. (NORTHERN IRELAND)  
 Meridio Trustees Ltd. (NORTHERN IRELAND)  
 Blinkx, Inc. (US)  
 Inktomi, Inc. (US)  
 Cardiff, Inc. (US)  
 Mediabin, Inc. (US)  
 iManage, Inc. (US)  
 Sritura, Inc. (US)  
 Virage GmbH (GERMANY)  
 Interwoven AS (NORWAY)



## Appendix 3

## U.K. transfer pricing - profit split report

**Transfer pricing rules**

broadly require that, for tax purposes, transactions between related parties are priced on terms that satisfy the arm's length standard.

Where transactions are very interrelated, with each party making unique and valuable contributions, it may be that they cannot be evaluated on a separate basis. The PSM may be appropriate in such cases.

Target has adopted the PSM for transfer pricing. Target appears to have complied with the requirements for preparation of its study and the risk of HMRC successfully challenging the methodology appears low.

**Overview**

U.K. transfer pricing rules broadly require that, for tax purposes, transactions between related parties are priced on terms that satisfy the arm's length standard. Where the actual terms of related party transactions depart from this standard, with the result that a party's liability to tax is reduced, an adjustment may be required to increase that party's tax liability to that which would have applied under the arm's length standard. There is not necessarily any corresponding downward adjustment to the profits of the other party, or a delay in claiming such an adjustment may be required.

In essence, transactions between related parties satisfy the arm's length standard when the conditions made or imposed do not differ from those that would be made between independent parties. Where this is the case, the profits accruing from the transactions between related parties are considered arm's length.

The OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* ("the OECD Guidelines"), which member states are encouraged to follow (and which are effectively incorporated into U.K. tax legislation) provide detailed descriptions of pricing methods that can be used to establish whether the arrangements are consistent with the arm's length principle.

We have conducted a high level analysis of the transfer pricing report, *Target – Transfer Pricing Study – Acquisitions of eTalk, Cardiff and Zantaz* ("the profit split report"). The profit split report was prepared by Deloitte in 2008. Under the version of the OECD Guidelines then published, there was a distinct hierarchy of methods – traditional transaction methods (particularly the CUP method) should be used, if possible, in preference to transactional profits methods (such as PSM). Parts of the OECD Guidelines were substantially revised in July 2010.

In selecting a transfer pricing method, it is important to find the most appropriate method for each individual case. The 2010 OECD Guidelines acknowledge there is no one method suitable for every case and therefore a number of factors must be considered when selecting the most appropriate method. It is not necessary to prove that a specific method is not suitable.

In particular, consideration should be given to the strengths and weaknesses of each method, the appropriateness of the method in light of the functional analysis, and the availability of reliable information needed to apply the method, among other factors.

Notwithstanding the 2010 revisions to the OECD Guidelines, it is still recognized that traditional transaction methods are generally the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are at arm's length. As a result, the OECD Guidelines continue to advise that the traditional transaction methods should be used in preference to the other methods wherever possible.

The profit split report has applied the OECD Guidelines (using, of course, the version that was published at the time). In our view it is likely that the approach adopted would also be reasonable under the 2010 version of the OECD Guidelines.

**Use of the PSM**

Where transactions are very interrelated, with each party making unique and valuable contributions, it may be that they cannot be evaluated on a separate basis. Under similar circumstances, independent enterprises might decide to set up a form of partnership and agree to a form of profit split. Accordingly, PSM seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realize by engaging in the transaction or transactions.



## Appendix 3

## U.K. transfer pricing - profit split report (2)

This is the approach that has been adopted in the profit split report.

The PSM splits the combined profit resulting from an integrated activity between the two companies based on the relative value of each company's contribution to the combined profit. This method is most applicable where transactions are very interrelated and cannot be evaluated on a separate basis, with each party making unique and valuable contributions.

One recognized approach to the PSM is the residual PSM. This approach has been adopted in the Deloitte transfer pricing report.

The residual PSM divides the combined profits or losses in two stages. The first ensures the participants are given a sufficient allocation to provide them with a basic return relating to their routine functions performed (if any), but which would generally not account for the return that would be generated by any unique and valuable assets of the participants. The second stage allocates any residual profit or loss in accordance with how this would have been allocated between independent enterprises based on an analysis of the facts and circumstances.

The residual profit represents the profit that cannot readily be assigned to routine functions, such as the profit arising from high-value, sometimes unique, intangibles.

#### Strengths of the PSM

One strength of the PSM is that it generally does not rely directly on closely comparable transactions, and it can therefore be used in cases when no such transactions between independent enterprises can be identified (for example, when valuable and unique IP is provided by both parties, as is the case here). The allocation of profit is based on the division of functions between the associated enterprises themselves.

External data from independent enterprises is relevant in the profit split analysis primarily to assess the value of the contributions that each associated enterprise makes to the transactions, and not to determine directly the division of profit. As a consequence, the PSM offers flexibility by taking into account specific, possibly unique, facts and circumstances of the associated enterprises that are not present in independent enterprises, while still constituting an arm's length approach to the extent that it reflects what independent enterprises reasonably would have done if faced with the same circumstances.

Another strength is that under the PSM it is less likely that either party to the controlled transaction will be left with an extreme and improbable profit result, since both parties to the transaction are evaluated.

#### Weakness of the PSM

There are a number of weaknesses with the model, of which it the most significant in this case is that the implementation of the PSM is necessarily reliant on a number of data sources and/or assumptions. It may be more difficult to support the data and assumptions by reference to comparable independent data. Tax authorities may therefore identify more opportunities for challenging the conclusions drawn under the method's implementation in a particular case, even where the methodology itself is accepted.





## Appendix 3

## U.K. transfer pricing - profit split report (3)

## Selection of the profit split method

Based on our reading of the profit split report, it appears that the profits under consideration are generated from a combination of the following sources:

- distribution activity conducted by the U.S. Group (a routine function);
- IP developed and owned by the U.S. Group; and
- IP developed and owned by the U.K. parent.

The purpose of the profit split analysis is to identify an arm's length royalty to be granted to the U.K. parent with respect to the value it has contributed to U.S. sales – namely, the value of its IP.

The main factors leading to the selection of the PSM in the profit split report were as follows:

- The introduction to Section 6 states that :
  - *"U.K. parent provides eTalk, Verity Cardiff and Zantaz with iDOL technology, benefits from the association with Target's name and reputation and business expertise. This has enabled the U.S. Group [to] provide new customers with a more sophisticated product, benefit from reduced costs and enhance their reputation by having access to Target's brand name."*
- The report does note, at 7.2, that
  - *"transaction based methods are favoured by tax authorities so a profit based method such as the profit split should only be used where the traditional transaction methods cannot be reliably applied."*
  - In our view this caveat is appropriate. Nevertheless, based on the information in the functional analysis, the conclusion that the interlinked contributions of the parties means that the PSM is the most appropriate method seems reasonable.

The key issue in selection of the PSM is the combination of IP which was developed individually by the U.K. parent and the U.S. Group. The implications of this for transfer pricing methodology selection are set out in Appendix 2 of the profit split report. In summary, the contribution of valuable IP by both the U.S. and U.K. parties, and the absence of publicly available comparable data, leads to the rejection of traditional transaction methods and the selection of the PSM as the most appropriate method.

The PSM operates to grant a routine return for the U.S. distribution function, and an allocation of residual profit with respect to U.S. IP, to the respective the U.S. Group. The remainder of the residual profit is granted to the U.K. parent as a royalty for the IP it has contributed to U.S. sales.

The absence of a routine return to the U.K. parent implies that the profit split report does not cover any U.K. sales of products involving the combined U.S. and U.K. IP. If there are any such sales, the transfer pricing treatment of these, which may affect the proportions of total profit allocated to each of the entities, should also be considered.

Again, in our view the rejection of alternative methods in Appendix 2 appears reasonable based on the information contained in the profit split report.

Further, in our view the conclusions drawn in the report would also be reasonable if it had been made under the revised version of the OECD Guidelines published in 2010.

However, there is no guarantee that the tax authorities would agree with the conclusion in the profit split report that the PSM is the most appropriate method. However, based on our experience it seems unlikely, on the basis of the facts as stated in the report, that a tax authority would successfully substitute a different transfer pricing methodology in this case.



## Appendix 3

## U.K. transfer pricing - profit split report (4)

The 2010 OECD Guidelines expressly state (at para 2.4):

*"cases where each of the parties makes valuable and unique contributions in relation to the controlled transaction . . . may make a transactional profit split more appropriate than a one-sided method."*

The above conclusion is dependent on the determination that both the U.K. parent and the U.S. parties have indeed contributed valuable and unique IP. A contrary determination (e.g., that the value in practice of one party's contribution is not material) could lead to the conclusion that a different methodology is more appropriate. The information in the profit split report indicates that both the U.K. parent and the U.S. Group have contributed valuable IP.

Alternatively, or in addition, the identification of a suitable CUP could affect the method selection. This is particularly relevant in light of the fact that only the U.S. Group appear to be selling the products that arise from the application of the jointly provided IP (discussed further below). It is theoretically possible, therefore, that the provision of IP from the U.K. parent to the U.S. Group could be priced by an application of the CUP method (e.g., to identify an arm's length royalty rate for comparable IP licences). Appendix 2 to the profit split report states that no such CUPs were identified.

We have not independently considered whether any CUPs are available, but in our experience it is difficult and often impossible to identify external CUPs for transactions involving valuable and unique IP. On the understanding that there are no internal CUPs, therefore (which is also stated in Appendix 2), it seems that in practice the PSM is the most appropriate method in this case.

Based on the information in the report, our view is therefore that the risk of a successful tax authority challenge to the selection of the PSM in this case is relatively low.

#### Application of the profit split method

##### Application of third party data

- As noted above, a strength of the PSM is that it can be applied where the nature of the transaction is such that little comparable third party information can be found to identify arm's length pricing. The corresponding weakness of the method is that its application can depend, at least in part, on interpretations that are supported by little independent third party data.
- The OECD Guidelines indicate that the PSM should be supported by independent data to the extent possible, but in our experience this is difficult to achieve in practice – especially since one of the reasons for selecting the PSM in the first place is that the transaction is not amenable to support from direct comparable data.
- The profit split report makes most notable reference to third party data in identifying the routine return to be allocated to the U.S. Group for their distribution activities. This return has been benchmarked using the TNM with OM as the most appropriate profit level indicator. Based on a U.S. comparable search, the profit split report concludes that an OM of 3.5% is a reasonable arm's length return to the U.S. Group for their routine distribution activities.
- In our experience the use of the TNM is often appropriate in benchmarking distribution returns, and the OM is a suitable profit level indicator in such cases. An OM of 3.5% is broadly consistent with our experience for routine distributors in the business software industry.



## Appendix 3

## U.K. transfer pricing - profit split report (5)

Our view is therefore that the transfer pricing risk arising from the application of a 3.5% OM for routine distribution activities is relatively low.

We understand that the 3.5% return only applies to acquired the U.S. Group entities, and that a separate U.S. Group entity within the group receives a 2% OM return for its routine distribution activities. While this is also broadly consistent with our experience for the industry, the reason(s) for the different returns within the group should be clearly documented.

## Allocation of the routine return

- The profit split report allocates the 3.5% OM return for routine distribution activities only to the U.S. Group.
- The return to the U.K. parent under the tested transactions is determined solely by the allocation of residual profit.
- In our experience, application of the residual PSM involving distribution is typically done by granting a routine distribution return to all parties making sales of the products resulting from the jointly provided IP.
- The implication from the one-sided allocation of the routine return is that only the U.S. Group is selling products resulting from the jointly-provided IP. The conclusion is that at arm's length the U.K. parent would require a royalty for the value of its IP that it provides to the U.S. parties; the arm's length amount of that royalty is calculated by the PSM.
- Provided the above summary of facts is accurate, our view is that the risk arising from the allocation of a routine return to the U.S. Group only is relatively low.

## Value driver analyses

- Again in connection with the use of interpretations (potentially subject to challenge) under the PSM, we have considered the value contribution analyses used to split the residual profit between the U.K. parent and the entities within the U.S. Group.

The value drivers identified in the report are:

- the ownership of product technology resulting from R&D activity;
- access to strategic business know-how;
- access to new customers; and
- business reputation and brand image.

The analyses are set out for each of three U.S. entities and each value driver individually. Percentage contributions to each value driver from the U.K. parent and each U.S. entity are provided for the years 2006 to 2010.

The consistent picture for each U.S. entity is that the weighting of the percentage contributions shifts from the U.S. entity to the U.K. parent over the five year period shown. This is said to reflect the increasing contribution of the U.K. parent to the overall value over time, as new centralized IP development activity (product enhancement, business development, etc.) progressively erodes the percentage contribution provided by U.S. entities.

The value contribution data was provided by management and we have not sought to independently verify the data or underlying assumptions, although they appear reasonable based on our experience. However, it is clear that different assumptions (e.g., different value drivers, a different weighting to the parties' respective contributions, or a different timescale for the shift in percentage contribution to the U.K.) could result in a change to the residual profit allocation.





## Appendix 3

## U.K. transfer pricing - profit split report – Interwoven addendum

We have conducted a high level analysis of the addendum to the profit split report prepared in 2009 to cover the acquisition of Interwoven.

It appears likely and has been assumed, though it does not appear to be explicitly stated, that this addendum has been prepared for the purpose only of splitting the residual profits between the U.K. parent and Interwoven, and that it should be read in conjunction with the main transfer pricing report.

On this assumption, the comments in relation to the main report should also apply to the Interwoven addendum.

In our experience, it would be difficult for tax authorities to produce stronger evidence than that provided by management as to the most appropriate data and/or interpretations to be used in performing the value contribution analysis. However, this should nevertheless still be regarded as an area of transfer pricing risk.

#### Interwoven

The report sets out a value driver analysis demonstrating the relative contributions of the U.K. parent and Interwoven to the value of the combined products.

As in the primary report, the percentage contributions of each of the parties shifts over time as the U.K. performs ongoing IP development activities.

It appears likely and has been assumed, though it does not appear to be explicitly stated, that this addendum has been prepared for the purpose only of splitting the residual profits between Tesla and Interwoven, and that it should be read in conjunction with the main transfer pricing report.

Thus, for instance, it is assumed that prior to the residual profit split Interwoven would also receive a routine return for its distribution functions, and that the 3.5% OM that was benchmarked in the profit split report is also appropriate for Interwoven.

The comments above with respect to the risks involved in the (necessarily subjective) value driver analysis contained in the main report apply also to the analysis contained in the Interwoven addendum to the report. On the assumption that the remainder of the profit split report applies to transactions with Interwoven in the same way as it applies to the transactions involving the other U.S. entities in the U.S. Group, the comments with respect to the profit split report should also apply to the Interwoven addendum.



## Appendix 4

## Target Tower Structure – steps in U.S. &amp; U.K. tax opinions (1)

**Steps outlined in provided U.S. and U.K. tax opinions**

The following steps were undertaken to set up the Tower structure.

*Step 1*

U.K. parent contributed the temporary intercompany funding balance with ANAH to AEHL in exchange for an issuance of one share.

*Step 2*

AEHL formalized the temporary intercompany funding balance with ANAH ("Loan A"), so that it is an interest-bearing loan to be denominated in U.S. dollars for \$175 million. The remainder of the intercompany balance (\$135 million) was capitalized for the issuance of one share.

*Step 3*

ANAH created two new U.S. LLCs, which are managed and controlled in the U.K. Therefore, both LLCs should be treated as a U.K. tax resident. ANAH made an initial capital contribution of \$10,000 to both LLCs with the balance left outstanding through an intercompany balances.

*Step 4*

ANAH transferred Interwoven to LLC 1 for market value, \$794 million. The consideration was in the form of a \$619 million capital contribution and LLC 1 issuing a loan note for \$175 million ("Loan B").

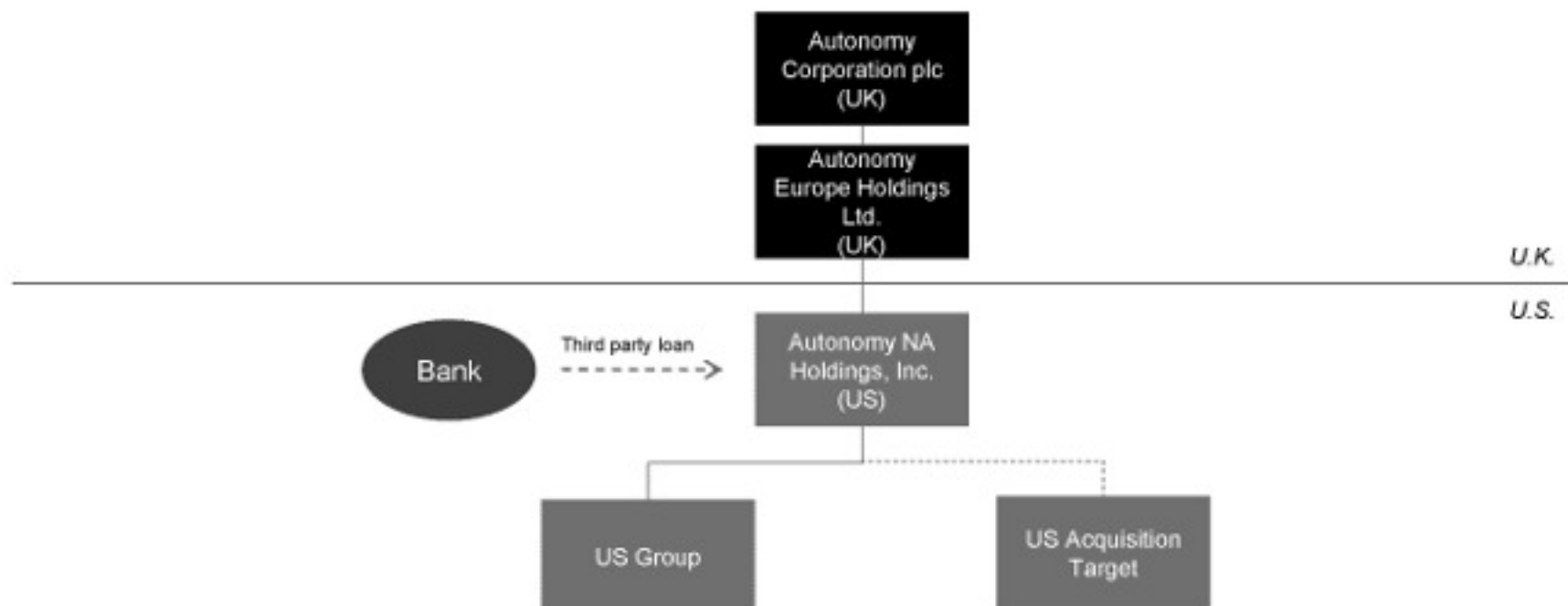
*Step 5*

LLC 2 entered into a swap with LLC 1. The swap required LLC 1 to receive dollar amounts of interest from LLC 2 which will mirror the terms of the loan from ANAH to LLC 1. As both LLC 1 and LLC 2 have a sterling functional currency, this creates a dollar liability in LLC 2 which offsets the dollar asset held by AEHL which also has a sterling functional currency. The overall result is that Target is not exposed to a net foreign exchange position with respect to this transaction.



## Appendix 4

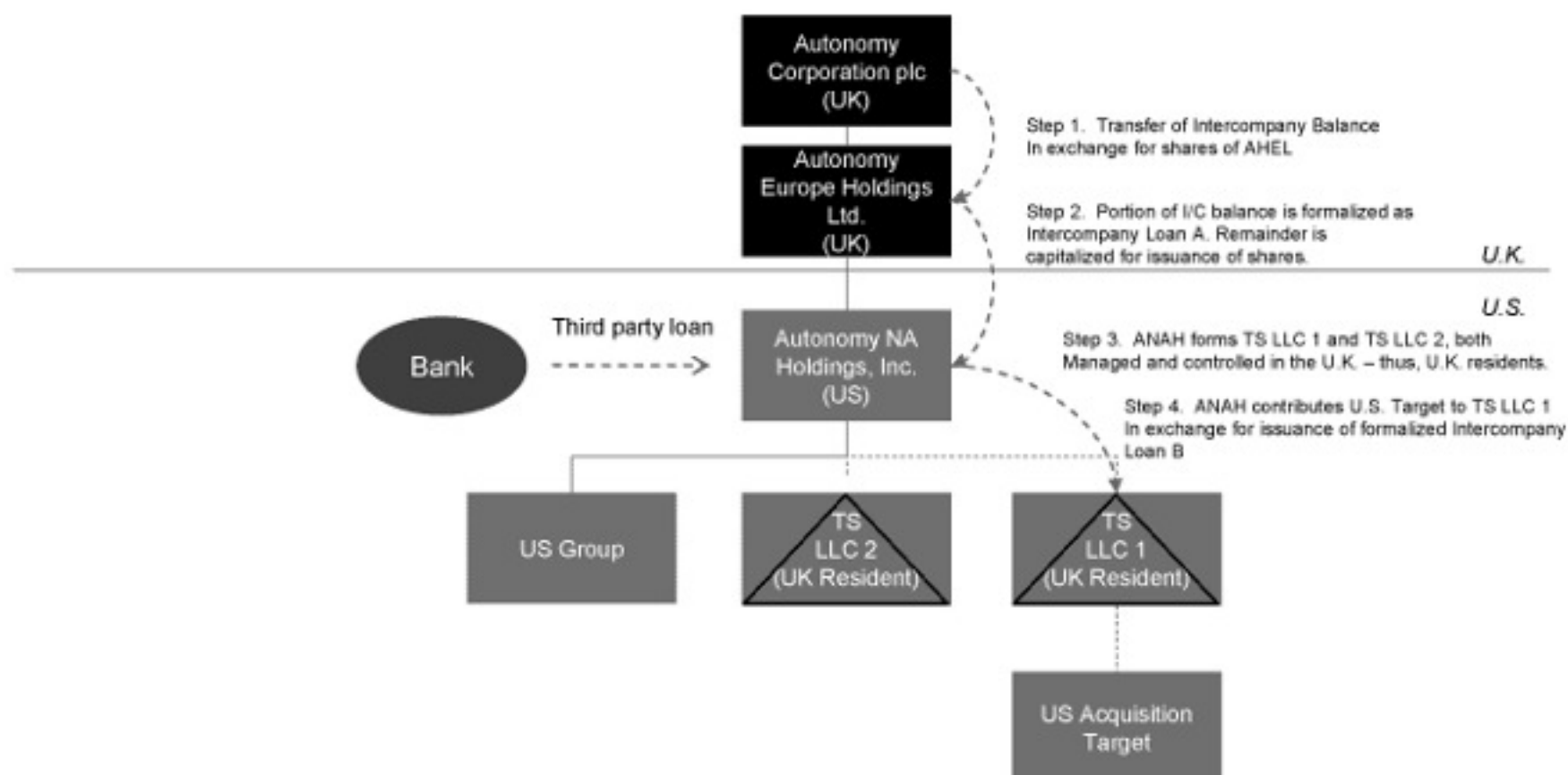
## Target Tower Structure – prior to implementation (2)





## Appendix 4

## Target Tower Structure – after implementation (3)



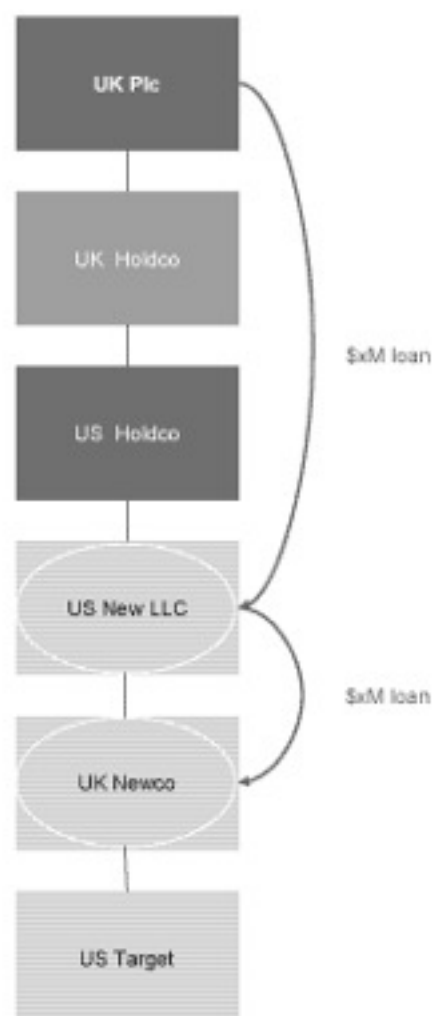
Note: Interest Payment by ANAH on Loan A is deductible for U.S. federal tax purposes. Any interest expense payment by TS LLC 1 on Loan B is disregarded for U.S. federal tax purposes. However, the interest expense payment by TS LLC 1 is deductible as interest expense for U.K. tax purposes. As such, the interest payment by TS LLC 1 offsets U.K. interest income received by AEHL paid by ANAH on Loan A.  
Source: E&Y U.S. tax opinion





## Appendix 4

## Typical Tower Structure – typical general observations

**Outline of idea – structure for acquisition of U.S. target**

- U.S. Holdco forms U.S. New LLC.
- U.S. New LLC incorporates U.K. Newco and U.K. Newco makes a U.S. tax election to be disregarded.
- U.K. plc advances a loan to U.S. New LLC.
- U.S. New LLC makes a loan to U.K. Newco and subscribes for equity.
- U.K. Newco acquires U.S. Target and using the proceeds from the above loan.

**Benefits of the structure**

- U.S. tax deduction for the interest when paid by U.S. New LLC, subject to any applicable limitations (e.g. IRC sections 163(j) and 267, etc).
- Tax deduction in U.K. Newco to offset the interest income of U.K. plc.
- The interest paid by U.K. Newco to U.S. New LLC is disregarded for U.S. tax purposes; thus there is no U.S. interest recognition.

**U.K. Points to consider**

- U.K. Tax arbitrage rules – clearance unlikely hence inclusion of U.S. New LLC;
- Worldwide debt cap rules – unlikely to be any adverse implications;
- CFC status of U.S. Holdco, and U.S. New LLC to be managed;
- Application of the U.K. disguised interest – unlikely to apply;
- Application of the 'group mismatch' rules – unlikely to apply; and
- WHT on interest payments by U.K. Newco – unlikely to be able to pay gross under the U.K.-U.S. double tax treaty, however this could be overcome by issuing debt as a listed Eurobond in the Channel Islands.

**U.S. points to consider**

- Earnings stripping;
- Transfer pricing;
- Dual consolidated loss;
- Conduit financing;
- Application of U.S./U.K. Treaty; and
- Impact of new economic substance rules.



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