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Economic Analysis of Receivables Transactions Involving McKesson Canada Corporation and McKesson International Holdings III S.ar.l.: Fiscal Year 2003

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McKesson Canada Transfer Pricing Report

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I. Executive Summary

A. Assignment and Valuation Issues

McKesson Canada Corporation ("MCC"), an indirect wholly owned subsidiary of McKesson Corporation (a U.S. company), transferred its existing and future (for five years) eligible receivables[1] and related assets to McKesson International Holdings III S.ar.l. of Luxembourg ("MIH") on December 16, 2002. In addition, MIH appointed MCC as its servicing agent for these receivables.[2]

As described above, MCC engaged in two intercompany transactions at issue: (1) the sale of receivables to MIH (expressed as a discount from the amount owed); and (2) the performance of servicing agent services on behalf of MIH. TD Securities offered an opinion on the price/discount in "Letter from Barbara Hooper to McKesson Canada Corporation and Blake Cassels & Graydon, LLP, December 16, 2002," ("TD DISCOUNT STUDY") and on the service fee in "Letter from Barbara Hooper to McKesson Canada Corporation and Blake Cassels & Graydon, LLP, April 25, 2003" ("TD SERVICE FEE STUDY"). In addition, PriceWaterhouseCoopers prepared an opinion on the price/discount in, "PriceWaterhouseCoopers, McKesson Canada Corporation, Factoring Review, December 14, 2005," ("PWC DISCOUNT STUDY"). Generally consistent with the results of these studies, MCC set the transfer prices as follows:

- MIH paid for the receivables at a price that provided a (gross) discount of 2.2062 percent ($48.3 million) from list price on the approximately $2.2 billion[3] over the period at issue: December 16, 2002 – March 29, 2003.[4] See **Tables 1A-1B**.

- MCC received a fee of $800,000 per month to service the receivables on behalf of MIH. This translates to approximately 0.1317 percent of list

[1] A small portion of MCC's receivables including those defined as "Arrangements and Inter-Co Receivables" were not transferred. Canada Revenue Agency. (10 January 2008). Taxpayer Response to Audit Query No. T119-11.

[2] McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement"; and McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement."

[3] All dollars are in Canadian dollars unless specified otherwise.

[4] The financial data provided by the taxpayer are divided into 13 periods per year. Period 10 through period 13 cover the dates December 9, 2002 through March 29, 2003 in the year ended March 2003. Unless otherwise specified, for the post-RSA period, I apply Periods 10-13. These periods are closest to the tax period at issue.

price, or $2.9 million over the period at issue. Thus, MIH effectively paid for the receivables at list price, less a *net* discount of approximately 2.0745 percent ($45.4 million). See **Tables 1A-1B**.

The taxpayer provided the TD DISCOUNT STUDY, the TD SERVICE FEE STUDY, the PWC DISCOUNT STUDY, and other documentation to the Canada Revenue Agency ("CRA") to support the above prices as being consistent with arm's length expectations. CRA has disputed certain portions of the taxpayer's transfer pricing analysis.

The Department of Justice Canada ("DOJ") has hired Precision Economics, LLC to economically analyze—in a report signed by Brian Becker—the two intercompany transfers described above based upon the information currently available—as of the date on the cover page of this report—over the December 16, 2002 through March 29, 2003 audit period. The first part of this assignment is to critically analyze the taxpayer submissions to determine whether the reported transfer prices:

- Were consistent with arm's length expectations; *or*
- Could be slightly adjusted to compute values consistent with arm's length expectations; *or*
- Required the application of entirely different transfer pricing methodologies to compute values consistent with arm's length expectations.

After finding that the transfer prices proposed by the taxpayer were *not* consistent with arm's length expectations, I performed *affirmative* valuations of these transfers. In particular, I found that:

- At arm's length, the "net" discount (inclusive of paying back a servicing fee) would be approximately 0.8386 percent, or $18.3 million. See **Table 16.**
- The arm's length net discount rate would have yielded MCC approximately $27.0 million more profit in Canada than it proposed. See **Table 16**.

I have completed these assignments for DOJ in this signed economic report, which represents my opinions as of the date on the cover page. My analysis and conclusions are presented in more detail in Section I.D below as well as in Chapters IV-V. I reserve the right to reconsider these opinions if new information is made available to me.

B. Materials Reviewed

I analyzed the MCKESSON CANADA transfer prices using publicly available documents and documents supplied by MCKESSON CANADA as part of this dispute. Some of the documents reviewed are listed below:[5]

- "Letter from Barbara Hooper to McKesson Canada Corporation and Blake Cassels & Graydon, LLP, December 16, 2002";
- "Letter from Barbara Hooper to McKesson Canada Corporation and Blake Cassels & Graydon, LLP, April 25, 2003";
- "PriceWaterhouseCoopers, McKesson Canada Corporation, Factoring Review, December 14, 2005";
- Case briefings by DOJ and the taxpayer as referenced below;
- MCC, MIH, and McKesson Corporation financial statements;
- McKesson Corporation Forms 10-K, 2002-2004; and
- Intercompany agreements between MIH and MCC.

C. Qualifications

My name is Brian C. Becker. I am the founder and President of Precision Economics. A copy of my current curriculum vitae, which includes a complete listing of my publications, teaching experience, and expert testimony, is attached to this report as Appendix A.

I have been employed as a consulting economist for more than 18 years. Prior to founding Precision Economics in 2001, I gained experience with several consulting firms. My primary areas of focus in these positions were in transfer pricing, business valuation, international trade, intellectual property, and financial damages.

In the transfer pricing/valuation area, I have testified as an expert witness, published more than twenty articles, and spoken to a number of industry/government groups. In total, this experience includes more than 400 transfer pricing reports for taxpayers, law firms, and tax authorities. Among my primary areas of focus in these analysis has been financial products and risk analysis. This has included the determination of arm's length credit ratings/credit worthiness (probability of payback), guarantee fees, and interest rates.

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[5] Appendix B contains a complete listing of the documents I relied upon in these analyses.

I have provided expert deposition and trial testimony in various venues, including The Administrative Appeals Tribunal (Australia), The Canadian International Trade Tribunal, The Federal Court of Australia, The Tax Court of Canada, The U.S. International Trade Commission, and U.S. Tax Court. Among recent assignments that are a matter of public record, I served as a transfer pricing economic expert for the U.S. Internal Revenue Service in its 2006 dispute with GlaxoSmithKline involving tangible goods and intangible property. In 2008 and 2009, I served as a transfer pricing economic expert for the Australian Government Solicitor and the Australian Taxation Office in Australia's first two major transfer pricing trials (Roche and SNF) involving the inbound purchases of tangible goods. In 2009, I served as a transfer pricing economic expert for the Department of Justice Canada and the Canada Revenue Agency in a transfer pricing dispute with General Electric involving financial guarantees. In 2010, I testified as an expert witness in a U.S. Tax Court transfer pricing matter involving intercompany services with Weekend Warrior Trailers, Inc.

My academic background includes teaching positions at four universities and a variety of published research. Most recently, at Johns Hopkins University, I taught Corporate Finance and Derivative Securities to MBA students where the topics focused on the quantification of risk and return. I have published more than two dozen articles and book chapters, including in the *Tax Management Transfer Pricing Report*, *Corporate Business Taxation Monthly*, *Business Valuation Review*, and *Business Valuation Digest.* This research includes the incorporation of risk/return with regards to discount rates as well as the arm's length accounting for receivables (and payables and inventory) in comparing profits across companies.

I received my B.A. in Applied Mathematics and Economics from the Johns Hopkins University. I received my M.A. and Ph.D. in Applied Economics from the Wharton School of the University of Pennsylvania.

D. Summary of Findings

My analysis contained in the Chapters below determined the arm's length net discount rate for the receivables sale/service transaction described above. In particular, I concluded that arm's length parties would agree to a net discount rate of 0.8386 percent. At the taxpayer's proposed servicing fee, this translates to a "gross" discount of 0.9703 percent. Such arm's length payments would have yielded an additional $27.0 million in MCC profit during the audit period. See **Tables 15-16**.

Taxpayer Critical Analysis

I found mathematical and conceptual errors in the taxpayer's submissions that led to non-arm's length results. Mathematically, the largest error in these submissions involved the cost of capital discount. See **Table 6**. Both the TD DISCOUNT STUDY and the PWC DISCOUNT STUDY adjust the (gross) discount rate upwards on the assumption that MCC would offer MIH a lower price than a company with a stronger balance sheet. However, in typical arm's length transactions, purchasers do not receive a better (or worse) cash deal as a result of holding significant debt. As MIH pays for the receivables in cash (it does not accept a loan from MCC), the value of this cash is unaffected by the purchaser's balance sheet. As such, the cost of capital should not be included as a component of the discount rate.

The second taxpayer error making a similarly large mathematical impact was the loss discount—a proxy for receivables that never get paid. As seen in **Table 7**, MCC historically suffered such losses approximately 0.04 percent of the time. The taxpayer, however, chose to apply discounts of 5 to 10 times these historical levels. See **Table 6**.

The taxpayer's third (mathematically) significant error involved servicing. The taxpayer models these transactions as having: (a) MIH *receiving* (from MCC) a discount to cover the arm's length costs of finding (and paying) someone to service the receivables; and (b) MIH *paying* (to MCC) an arm's length fee to cover said services. As the two payments cover the *same* services at the same time and they flow in opposite directions, they should "net" to a zero payment. The taxpayer's application (TD DISCOUNT STUDY) diverts from arm's length levels because it suggests that a receivable buyer (MIH) would receive a servicing discount of approximately *five times* the costs required to obtain/perform those services. See **Table 6**.

The transfer pricing analytical errors would manifest themselves in the financial statements of the two parties. While other factors also influence these results, MCC's historical financial results—modest finance charges and positive profits—reversed after these transactions began to occur. See **Table 17**.

Affirmative Valuation

I perform two valuations of the net (and gross) discounts that arrive at similar results (see **Table 15**)—both of which represent approximately 40 percent of the discount proposed by the taxpayer. An economically appropriate "build-up" valuation follows the overall logic of the taxpayer approaches and corrects the errors mentioned above (and other minor mathematical adjustments). See **Table 10**. I also considered the discount rate paid by an unrelated party, TD Factors Limited, in a similar agreement for MCC receivables, adjusted for any differences in agreement terms. See Tables **11-14**.

E. Organization of Report

I organize this report into five chapters, supporting tables, and various appendices. This first chapter outlines the scope of the project and summarizes the conclusions. Chapter II summarizes the facts at issue. Chapter III describes how the arm's length valuation standard applies in general and in this case, specifically. I critically analyze the taxpayer's submissions/results in Chapter IV. My affirmative valuation is contained in Chapter V. Appendices and tables follow the text.

II. Factual Background

A. McKesson Background

1. McKesson Corporation

Founded in 1833 by John McKesson and Charles Olcott in New York, McKesson Corporation primarily distributes pharmaceuticals and other healthcare products throughout North America. Its clients include regional and national retail chains, institutional providers and retail independent pharmacies. It enjoys the largest customer base in the healthcare industry, and is a Fortune 20 company.[6]

In 2003, McKesson's operations were principally focused in the United States and Canada. Headquartered in San Francisco, California, McKesson generated revenues of USD $57.1 billion (see **Table 5A**) in fiscal year 2003 with its pharmaceutical solutions division accounting for approximately 93 percent of revenues.[7]

2. McKesson Canada Corporation

MCC incorporated in 1905 as the National Drug and Chemical Company of Canada. Having experienced several changes in both name and corporate structure during early parts of the 20th century, MCC became a wholly owned subsidiary of McKesson in 1991. Between 1992 and 1997, MCC continued to grow, both internally as well as through acquisitions.[8] In 2002, MCC adopted the name McKesson Canada.[9] Like its U.S. parent, MCC enjoyed a position as the leading provider of pharmaceuticals and other healthcare products in Canada.

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[6] McKesson Corporation. (6 June 2003). Form 10-K for the Fiscal Year Ended March 31, 2003, p. 3; and Retrieved 9 September 2009 from http://www.mckesson.com/en_us/McKesson.com/About%2BUs/Our%2BCompany/Our%2BHistory.html.

[7] McKesson Corporation. (6 June 2003). Form 10-K for the Fiscal Year Ended March 31, 2003, p. 88.

[8] In 1992, Medis Health and Pharmaceutical Services acquired Focus Pharmaceutical Group in Quebec. In 1997, Medis Health and Pharmaceutical Services acquired the distribution services of Drug Trading Company.

[9] Retrieved 9 September 2009 from http://mckesson.ca/en/mckesson.ca/history.aspx.

3. McKesson International Holdings

MIH incorporated in Luxembourg on September 25, 2002 as a "société à responsabilité limitée." In that capacity, MIH operated similar to a holding company with administrative and management responsibilities. In this capacity, MIH did not employ any staff.[10]

B. Financial Statements

1. McKesson Corporation

McKesson experienced significant growth in both sales and operating profit over the 2000-2003 period. Revenues increased from USD $36.7 billion in 2000 to USD $57.1 billion in 2003. Operating profits witnessed even faster growth from USD $109.5 million in 2000 to USD $933.0 million in 2003. See **Table 5A**.

McKesson's balance sheet also witnessed growth from 2000 to 2003. As of March 31, 2003, McKesson reported assets and equity of USD $14.4 billion and USD $4.5 billion, respectively. See **Table 5B**.

2. MCC

MCC generally reported similar trends (consistently positive, but modest profit margins) as its parent corporation. However, that pattern changed at the end of fiscal year 2003. In particular, MCC reported a loss during the period after signing the Receivables Sale Agreement ("RSA") with MIH in December of 2002. While MCC's operating margin stayed relatively consistent (even growing in the end of 2003) after the RSA, its finance charges—which include the receivables discount provided to MIH[11]—increased more than tenfold from approximately 0.3 percent of sales in 2000-2002 to approximately 3.0 percent of sales. See **Table 4A**.

The change of receivables financing coincided with a noticeable change in MCC's balance sheet at the end of 2003. In particular, its assets (and liabilities) declined. In total, the book value of its equity became negative by the end of fiscal year 2003. See **Table 4B**.

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[10] McKesson International Holdings III S.ar.l. (2003). "Financial Statements for the Period from September 25, 2002 (Date of Incorporation) to March 31, 2003," p. 9. Alternatively known as Document R-130.

[11] McKesson Canada Corporation. (2003). "Statement of Earnings (Unaudited) As of 29 March 2003"; and McKesson Canada Corporation. (2003). "Amended Statement of Earnings As of 29 March 2003." Alternatively known as Document R-70.

3. MIH

MIH reports financial statements, but these financial statements provide relatively little information regarding market value for revenues or costs. That is, its "line items" essentially reflect McKesson's proposed transfer prices.[12]

C. Operations

MCC carries more than 35,000 products in 16 distribution centers and provides logistics and distribution to over 800 manufacturers. In this role, MCC delivers products to 6,300 retail pharmacies, 1,350 hospitals, long-term care centers, clinics and institutions in Canada.[13] MCC's major competitors in the healthcare distribution industry include Cardinal Health, Inc. and AmerisourceBergen Corporation.[14]

D. Intercompany Transactions

1. Receivables Sale Agreement (RSA)

On December 16, 2002, MCC and MIH signed the RSA, for a five year term.[15] The agreement provided for the sale of the right, title and interest in all eligible receivables owned by MCC to MIH as of December 16, 2002, and all subsequent receivables arising prior to the termination date subject to the facility limit of $900 million.[16] As the receivables "turned over" several times during the audit period at issue, MIH actually purchased more than $2 billion. See **Tables 1A-1B**. MIH purchased receivables at the face value of the receivables less a calculated *gross* "discount rate."

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[12] McKesson International Holdings III S.a.r.l. "Financial Statements for the Period from September 25, 2002 (Date of Incorporation) to March 31, 2003," pp. 7-9. Alternatively known as Document R-130.

[13] Retrieved 9 September 2009 from http://www.mckesson.ca/.

[14] Retrieved 9 September 2009 from http://www.hoovers.com/mckesson-canada/--ID__121777--/free-co-factsheet.xhtml.

[15] The RSA terminated after five years or because of a termination event. Examples of these termination events include: (1) delinquency ratio was greater than 2.5 percent; (2) loss ratio was greater than 0.25 percent; or (3) McKesson Corporation's credit rating by Moody's or S&P was withdrawn or falls below Baa3 and BBB-, respectively. McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," pp. 18-19.

[16] McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," p. 4.

2. Servicing Agreement

MIH designated and appointed MCC as its servicer to administer and collect receivables related to the RSA for a monthly service fee.[17] Thus, incorporating the two transactions together, MIH essentially paid for the receivables, less a single net discount. See **Tables 1A-1B**.

[17] McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement," pp. 1 & 6; and McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix G.

III. Arm's Length Standard

As summarized in Chapter I, I have been requested to opine upon valuation approaches and results regarding the intercompany transfer prices under examination. Thus, it is first important to define and describe the arm's length standard considered in such valuations. This chapter describes how such a standard attempts to mimic the (supply, demand, etc.) market forces inherent in unrelated transactions to related party transfers. That is, the standard demands the valuation of *hypothetical* unrelated transactions under circumstances that are otherwise similar to those of the related party transfers at issue. While this concept is relatively simple to describe, it requires further discussion to fully define and value specific transactions.

A. Arm's Length Principle: Definition

Transactions that are typically witnessed in markets around the world involve two parties that are not commonly owned—*i.e.*, they are transacting at "arm's length." These transactions' resulting prices are naturally impacted by market forces. Put more broadly, the buyer attempts to pay as little as possible and the seller attempts to extract as high a price as possible—with the ultimate price largely determined by the positions/bargaining power of the two parties.[18]

While multinational companies have various business reasons to transfer tangible property, intangible property, and services from one *related party* to another, the pricing of these transfers does *not* respond to inherent market forces. Rather, the multinational company could set its transfer prices at whatever levels it chose—but for transfer pricing regulations and enforcement thereof.[19]

Related company transfer pricing is not directly governed by market forces, but it is broadly governed by a consistent standard that attempts to mimic market forces—generally

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[18] Often referred to as the "invisible hand" (coined by Adam Smith in 1776), a generally accepted economic principle states that market economies include many buyers and sellers of numerous goods and services that act to promote their self-interest. Mankiw, N. Gregory. (2007). Principles of Economics. South-Western, pp. 9-10, and Chapter 7.

[19] See, for example: Li, Jinyan. (2002). "Global Profit Split: An Evolutionary Approach to International Income Allocation." Canadian Tax Journal. Vol. 50, Iss. 3.

known as the arm's length standard.[20] This standard requires intercompany transfer prices to be set at the level (in terms of price, fee, rate, etc.) that would have been achieved under hypothetically similar circumstances, but assuming that the trading parties had *not* been related to each other.

The *concept* of the arm's length standard is relatively simple, but its *application* is often complicated, as it requires the economist to artificially separate all of the operations/relationships existing between the transacting parties while keeping all other characteristics of each related party intact. Economists can perform this application in two steps. Step 1 defines the terms/characteristics of a transaction by creating/defining a hypothetical (arm's length) transaction. This hypothetical serves as a proxy for the intercompany transfer under arm's length circumstances.

Once the hypothetical transaction is fully defined and described, the determination of the price/fee/rate that would result represents Step 2. These valuations largely focus on locating and comparing various benchmarks/comparables that would provide information (*e.g.*, price, fee, rate, margins, profit splits, etc.) about the expectations of the transaction's pricing at arm's length. By considering the relative strengths of the various benchmarks (*e.g.*, reliability, adjustments, etc.), a single point or range of values can be determined.

B. Transfer Pricing Step 1: Defining the Hypothetical Transaction

The arm's length standard would price a related party transfer at the level that would be expected if the parties were operating at arm's length. As such, it is important to define all of the important characteristics that would be inherent in such a hypothetical arm's length transaction. This definition potentially includes:

- a description of the product, service, intangible, etc. being transferred;
- the timing of the transfer;

[20] I do not intend this statement to reflect a comprehensive opinion on transfer pricing rules and regulations in each country of the world. In that sense, it is possible that certain provisions in certain countries may be interpreted to disagree with the arm's length standard, but it is the typical standard applied in valuations by economic practitioners in this field—and the standard I have been asked to follow in drafting my opinions for this report. See, for example: Organisation for Economic Co-operation and Development. (July 1995). Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, Chapter I; and Australian Taxation Office. (April 2005). "International Transfer Pricing." Retrieved 26 February 2009 from http://www.ato.gov.au/content/downloads/LBI_35285_Applying_arms_length_principle.pdf.

- the primary terms in the transaction (*e.g.*, time period, volume, termination terms, etc.);

- the characteristics of the seller (*e.g.*, Canadian subsidiary of a multinational) that would potentially influence its bargaining power; and

- the characteristics of the buyer (*e.g.*, a Luxembourg subsidiary of a *different* multinational) that would potentially influence its bargaining power.

While the definition step in transfer pricing is quite important, it often requires relatively little *analysis*, as it simply reflects a listing of known facts.[21, 22] In certain cases, however, further adjustments/descriptions are required, including:

- **Terms Not Followed**: Related parties do not face the same level of market forces (*e.g.*, threats of lawsuits and/or the termination of an agreement) that require them to follow the terms of their agreements. As such, related parties' behavior does not always coincide with the terms in their intercompany agreements. In such cases, the transaction's description in the hypothetical construct in Step 1 of the transfer pricing analysis would focus on the actual behavior of the parties, not the terms stated in the intercompany agreement.

- **Identity of the Selling/Licensor Party Itself Being Transferred**: In most transfer pricing analyses, the product/service/asset being transferred is of primary importance, while the identity and characteristics of the selling entity itself have less importance. However, in cases where the identity or reputation of the selling entity is essentially being transferred/licensed (*i.e.*, royalty rate for company name, guarantee fee, etc.), the focus of the hypothetical description would be more heavily weighted to the seller's characteristics.[23]

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[21] Thus, most research and discussion on transfer pricing focuses on the valuation step as opposed to the definition step. See, for example: Feinschreiber, Robert. (2004). Transfer Pricing Methods. John Wiley & Sons, Inc: New Jersey, Table of Contents.

[22] The definitional step is often implicitly incorporated into the second step (valuation). That is, for example, the economist may analyze strategic issues of the parties as part of a valuation analysis.

[23] Analogously, the characteristics of the buyer would potentially be more relevant in some of these situations also. For example, a small food supplying company may gain some instant credibility if it begins selling to McDonald's.

C. Transfer Pricing Step 2: Valuation

Transfer pricing economic reports are similar to other economic expert witness reports in that they benefit from not only the economist's opinion, but also from a description of the data, methodologies, and assumptions applied in reaching such opinion. In the case of transfer pricing, the *valuation* methods largely center on: (1) the consideration of benchmark data (comparables) that have been naturally impacted by market forces; and (2) the potential comparables' relevance to the pricing of the hypothetical transaction at issue.

Various types of data exist publicly—and/or through proprietary data from the multinational taxpayer being analyzed—that show the impact of market forces. Prices, royalty rates, and service fees agreed to in transactions between unrelated parties provide one such type of benchmark data, or comparable.[24] Transactional gross margins also provide potential comparable data used by economists to calculate transfer prices. In addition to transactional benchmarks, overall corporate or product line profits for one (or both) of the parties to the transaction can be set at a level determined by comparables.[25]

In this valuation step in transfer pricing, the various methods (including their comparables) would be evaluated based upon their relative reliability. In this sense, the economist would compare how close ("exact") the comparables are to the hypothetical construct at issue. To the degree differences exist, the economist would evaluate how such differences were adjusted for[26]—if they could be quantified at all. In general, methods that are more direct and require fewer adjustments/assumptions are preferred to methods requiring a significant number of adjustments and assumptions/estimations. In transfer pricing terminology, this process would ultimately determine a best method(s)[27] and a resulting transfer price.[28]

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[24] In transfer pricing, it is common practice to refer to the arm's length benchmarks (impacted by market forces) as comparables. See, for example: Broomhall, David. (21 March 2007). "Updating Comparables in Advance Pricing Agreements." Tax Management Transfer Pricing Report. Vol. 15, No. 22.

[25] Economists also consider market values, useful lives, interest rates, Betas, debt ratings, debt/equity ratios, and other benchmarks. Rosenblum, Jeffrey I. (16 October 2002). "Estimating an Arm's-Length Interest Rate on Intercompany Loans." Tax Management: Transfer Pricing. Vol. 11, No. 12, p. 602.

[26] In theory, any benchmark could potentially be adjusted to any hypothetical, but some are easier to imagine than others. For example, it would be relatively difficult to adjust the price of a diamond to the discount to be paid on receivables.

[27] Often, multiple primary methods are applied in tandem and/or a secondary test of reasonableness is used to confirm the results of a primary method.

[28] See, for example: Feinschreiber, Robert. (2004). Transfer Pricing Methods. John Wiley & Sons, Inc: New Jersey, pp. 40-42.

D. Step 1 Applied to McKesson

Step 1 in transfer pricing analyses typically creates/defines the hypothetical arm's length transaction based upon the characteristics of the actual related party transaction. **Table 2** describes the actual transfers at issue between MCC and MIH, including the characteristics of the purchaser and seller. While any of the characteristics could potentially impact pricing, some that are likely to be at issue in this case are:

- prompt payment/other discount expectations;
- likelihood of receivables being paid by MCC's customers;
- expected days for average collection time;
- facility limit;
- functions of the parties; and
- termination events.

Translating the MCC/MIH transaction characteristics into the hypothetical arm's length transaction is mostly a matter of "cutting and pasting" except for the company descriptions. That is, both the buyer and the seller in the *actual* transaction are subsidiaries of *the same* multinational company. In the *hypothetical* arm's length transaction, the transacting parties would be subsidiaries of *different* hypothetical multinational companies—labeled "A" and "B" in **Table 3**. This hypothetical construction allows the transaction/companies to retain as much of their characteristics as possible in the arm's length setting.

E. Step 2 Applied to McKesson

Determining arm's length prices for the hypothetical receivable sales from a subsidiary of multinational A to a subsidiary of multinational B is dependent on the data available. I work through this process in Chapter IV by economically reviewing the taxpayer's evidence and resulting proposed transfer prices. Thereafter, in Chapter V, I perform my affirmative valuation of the intercompany transfers at arm's length.

IV. Economic Consideration of the Taxpayer's Evidence/Reports and Proposed Transfer Prices

The DOJ has engaged me to critically analyze the taxpayer's evidence/reports regarding the sale of accounts receivable from MCC to MIH, and the compensation received by MCC for acting as the servicer of those transferred accounts receivables. This "Economic Consideration" chapter—together with its associated tables/references—provides the reasoning behind, and summarizes my opinions on, these proposed transfer prices.

A. Description of Intercompany Transactions

From December 16, 2002 to March 29, 2003, MIH purchased approximately $2.2 billion (face value) in accounts receivables from MCC. The terms of the transactions between MCC and MIH were formally documented in two intercompany agreements: (1) the December 16, 2002 RSA between MCC and MIH; and (2) the December 16, 2002 Servicing Agreement between MCC and MIH. In particular, MIH purchased essentially all of MCC's accounts receivables over the period at issue.[29] The taxpayer has proposed that MIH pay face value less a gross discount of 2.2062 percent ($48.3 million) for these receivables at issue. The taxpayer also finds that MCC should receive a fee of 0.1317 percent ($2.9 million) for servicing the eligible accounts receivable. Thus, the net discount to MIH proposed by the taxpayer is 2.0745 percent ($45.4 million). See **Tables 1A-1B**.

B. Summary of Taxpayer's Evidence

The taxpayer's evidence on the MCC/MIH receivables discount focuses on two reports: (1) the TD DISCOUNT STUDY; and (2) the PWC DISCOUNT STUDY. The taxpayer provides another study—the TD SERVICE FEE STUDY—for its justification of the arm's length servicing payments to MCC by MIH.

1. Discount Rate (Payment) for MCC's Eligible Accounts Receivable

The TD DISCOUNT STUDY and the PWC DISCOUNT STUDY follow similar approaches to determine the proposed arm's length discount rate to apply to the accounts receivables transferred between MCC and MIH. That is, both studies identify and quantify six components to calculate the discount rate: (1) yield rate; (2) loss discount; (3) servicing

[29] The only substantial accounts receivables excluded from eligible receivables included those defined as "Arrangements and Inter-Co Receivables." For the period at issue (periods 9-13 of 2003), these accounts receivables totaled approximately $45.0 million. Canada Revenue Agency. (10 January 2008). Taxpayer Response to Audit Query No. T119-11.

discount; (4) prompt payment discount; (5) accrued rebate discount; and (6) cost of capital discount.

a. Yield Rate

The yield rate represents the short-term interest rate associated with the time to collection (time value of money) of the accounts receivables. Both the PWC DISCOUNT STUDY and the TD DISCOUNT STUDY apply a 30-day Canadian Deposit Offering Rate ("CDOR") for their yield rate calculations.[30] To determine the amount of time for these "time value of money" computations, they compute the expected/forecasted days sales outstanding ("DSO") of MCC's eligible accounts receivable.[31] From this application, the taxpayer finds that the yield rate component of the discount rate translates to approximately 0.2169 to 0.2602 percent of the receivables' face value. See **Table 6** and below.

Taxpayer Studies' Proposed Yield Rate: 2003

Taxpayer Studies	**TD DISCOUNT STUDY**	**PWC DISCOUNT STUDY**		**Formula**
		Low	**High**	
CDOR Rate	2.7886%	2.495%	2.495%	A
Days Sales Outstanding	31.73	31.73	38.08	B
Yield Rate	**0.2424%**	**0.2169%**	**0.2602%**	C = A*(B/365)

b. Loss Discount

The loss discount represents the credit risk of MCC's transferred accounts receivables—that is, the potential of customers' non-payment. Historically, the losses associated with non-payment by MCC's customers had averaged approximately 0.0440 percent of sales. See **Table 7**.

To determine the loss discount, the TD DISCOUNT STUDY and PWC DISCOUNT STUDY do not apply the 0.0440 percent discount rate, but rather take a different multi-step

[30] The CDOR is also referred to as the 30-day banker's acceptance rate index. The PWC DISOUNT STUDY uses an average rate over the prior year. The TD DISCOUNT STUDY uses the 10 December 2002 CDOR rate. Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., p. 10; and McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix B.

[31] The TD DISCOUNT STUDY applies a DSO of 31.73 days based on the MCC's historical three year average, whereas the PWC DISCOUNT STUDY uses the historical average DSO for the lower end of its range and adds a 20 percent buffer, using a DSO of approximately 38.08 days for the upper end of its yield rate range. See **Table 9**.

approach. First they divide (and take a weighted average of) MCC's transferred receivables into two groups:

- **Designated Obligors**: obligors representing more than 2 percent of the portfolio ("Designated Obligors"); and
- **Other Obligors**: the remaining obligors with receivables in MCC's portfolio ("Other Obligors").

For the *Designated Obligors*, both studies then determine the obligors' public credit ratings. Following this calculation, the studies calculate "spreads"—the difference in the annual interest rate on *debt* for these companies relative to a risk-free interest rate.[32] Both studies consider the probability of non-payment to MCC for these customers—the "Loss Discount"—as being equivalent to these spreads, adjusted for time.[33] From these calculations, they apply a loss rate of approximately 0.2 to 0.3 percent to the Designated Obligors.

The two studies take slightly different approaches in determining the credit spread for the Other Obligors:

- The TD DISCOUNT STUDY applies MCC's *average* historical losses, *plus* three "standard deviations" (*i.e.*, within the 99th percentile, or the top one percent),[34] resulting in a loss discount of 0.2300 percent.
- The PWC DISCOUNT STUDY employs its "spread" calculations, assuming the Other Obligors would be rated BB-. This resulted in a loss discount of 0.3807 to 0.4568 percent.

c. Servicing Discount

The taxpayer's service discount calculation incorporates the costs required to service/collect the purchased receivables.[35] MIH pays a servicing fee of 0.1317 percent of

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[32] The TD DISCOUNT STUDY provides limited information on its calculated credit spreads. The PWC DISCOUNT STUDY uses U.S government securities' one month average for the risk free rate. McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, p. 8.

[33] Both studies adjust the spread for a DSO of 31.73 days and the PWC DISOUNT STUDY also adjusts upward by a buffer of 20 percent for the high end. Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., pp. 5-6; and McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, p. 6.

[34] The calculations for these standard deviations have not been provided.

transferred receivables (to MCC). The taxpayer proposes the servicing discount under this approach to be as much as 0.6500 percent, or approximately 5 times MIH's service fees. See **Table 8**.

d. Prompt Payment Discount

Certain MCC customers can fulfill their payment with an early payment that is slightly *less* than face value—a "prompt payment" discount. The TD DISCOUNT STUDY and the PWC DISCOUNT STUDY quantify such prompt payments by referring to the historical prompt payment rate of approximately 0.5000 percent.[36] See **Table 6**.

e. Accrued Rebate Discount

MCC provides volume rebates to its customers. When MIH purchases the receivables, it remains MCC's obligation to pay the volume rebates. However, the taxpayer reasoned that obligors may become concerned about MCC's ability to pay the rebates, and would begin to net the rebate against the accounts receivables. That is, MCC's customers would begin to start "shorting" MCC in case MCC did not honor the volume rebates. The TD DISCOUNT STUDY and the PWC DISCOUNT STUDY estimate such accrued rebate discounts as approximately 0.0100 to 0.0244 percent of receivables, respectively. See **Table 6**.

f. Cost of Capital Discount

The final component of the taxpayer's gross discount rate is the cost of capital discount. Both taxpayer studies reason that MCC would allow MIH to enjoy a higher discount rate (lower net price) on the receivables purchase due to the latter's thin capitalization/relatively risky capital structure. That is, an owner of receivables would sell its receivables to a thinly capitalized company at a *lower* price than it would to other (less thinly capitalized) independent companies. Based on this logic, the studies estimate that a thinly capitalized company would receive a price discounted by an additional 0.4564 to 0.7824 percentage points—relative to the otherwise "market price" of such receivables. See **Table 6**.

g. Taxpayer's Proposed Gross Discount Rate

Based on the various components specified above, the studies calculate total gross discounts of approximately 1.9698 to 2.2646 percent. The taxpayer applies the TD DISCOUNT

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[35] Such a calculation is not necessary, and "nets" out when determining a *net* discount rate.

[36] The studies use a range of 0.5000 to 0.6000 percent.

STUDY's discount rate of 2.2029 percent. This "gross" discount, however, does not all accrue to MIH in net, as it pays the service fee summarized below back to MCC. See **Table 6**.

2. Service Fee from MIH to MCC and Net Discount Rate

The taxpayer estimates arm's length service fees for MIH to pay MCC by reference to fees paid in similar transactions between unrelated parties. In particular, it finds that a fee equivalent to approximately 0.1317 percent of total receivables is consistent with arm's length transactions. Thus, the taxpayer (TD DISCOUNT STUDY) proposes a "net" discount to MIH of approximately 2.0712 percent. See **Table 6** and below.

Taxpayer Studies' Proposed Net Discount Rate: 2003

Taxpayer Studies	TD DISCOUNT STUDY	PWC DISCOUNT STUDY		Formula
		Low	High	
Gross Discount Rate	2.2029%	1.9698%	2.2646%	A
Service Fee	0.1317%	0.1317%	0.1317%	B
Net Discount Rate	**2.0712%**	**1.8381%**	**2.1329%**	C = A-B

C. Economic Evaluation

The taxpayer studies do not result in transfer prices that are consistent with arm's length expectations. In their applications, the taxpayer submissions made a number of inappropriate and unsubstantiated assumptions. In addition, it did not appear that any "tests of reasonableness" were applied—or documented—to the results of these submissions.

In this economic evaluation of the taxpayer's studies, I first offer my major criticisms of the various submissions analyzing the transfer prices at issue. Thereafter, I briefly mention several minor critiques.

1. Failed Test of Reasonableness

In addition to adopting sound methodological approaches to calculate transfer prices, it is often equally important to analyze the *results* of transfer prices with certain tests of reasonableness. Such tests vary by case, but the taxpayer's submissions fail a number of logical tests, including:

- **Change in MCC's Historical Profits**: Prior to its transactions with MIH, MCC had consistently earned *positive* profits. By contrast, MCC had its only losses in the period when it engaged in these intercompany transactions with MIH. The losses did not appear to be a result of operations, as its operating margin in this period *exceeded* its margins in previous periods. That is, MCC's losses coincided with its relatively high finance charges (inclusive of its net discount) during this period. See **Table 4A** and below.

MCC's Financial Results as a Percentage of Sales: 2000-2003

MCC	2000	2001	2002	2003 (Pre-RSA Agreement)	2003 (Post RSA-Agreement)
Operating Margin	1.1%	1.1%	1.5%	1.5%	**2.4%**
Finance Charges	0.4%	0.3%	0.3%	0.2%	**3.0%**
Pre-Tax Margin	**0.6%**	**0.8%**	**1.2%**	**1.3%**	**Negative 0.5%**

- **MCC's Financing Expense**: While the *operations* of MCC remained successful/became more successful after the RSA, its financing expenses (below the operating profit line) changed significantly. As seen above and in **Table 4A**, its financing costs (including interacting with MIH) increased from approximately 0.2 to 0.4 percent of sales to 3.0 percent of sales after beginning its relationship with MIH.

The taxpayer failed these tests of reasonableness due to a variety of misapplications. The rest of this section describes some of these issues.

2. Cost of Capital Discount

Both the TD DISCOUNT STUDY and the PWC DISCOUNT STUDY adjust the (gross) discount rate upwards on the assumption that MCC would offer MIH a lower price than a company with a stronger balance sheet. However, neither study provides economic documentation/explanation of why a *seller* of receivables would be willing to charge a purchaser a higher or lower price based on the purchaser's capital structure. That is, why it would accept a *cash* payment of $9 from one company when another company would be willing to pay $10 in cash. Rather, in typical arm's length transactions, *purchasers* do *not* receive a better (or worse) cash deal as a result of holding significant debt. As MIH pays for the receivables in cash (it does not accept a loan from MCC), the value of this cash is unaffected by the purchaser's balance sheet. To the degree MIH did not have cash available to make purchases, MCC could simply refuse to provide its receivables.

MCC would not consider *MIH*'s capital structure when entering into the RSA. If MIH is unable to accept similar discount rates of other arm's length competitors in the marketplace that are *not* thinly capitalized, then MCC would complete the RSA with another party—at a lower discount rate. As such, the cost of MIH's capital should not be included as a component of the discount rate at all. As seen in **Table 6**, this misapplication alone artificially inflates the taxpayer's estimated discount rate by approximately 46 to 78 basis points—translating to approximately $10 million to $17 million in this period of time.

3. Loss Discount

The taxpayer's studies set a loss discount as a proxy for receivables that are "lost"—never get paid. Historically, MCC suffered such losses approximately 0.04 percent of the time. Instead of applying this level—4 basis points—for loss discounts, the taxpayer applied loss discounts of 23 to 46 basis points—or approximately 5 to 10 *times* historical levels. See **Table 7**. This incremental increase to the loss discount translates to approximately $4 million to $9 million.[37]

The difference in the taxpayer studies' loss discount and the historical averages can partially be explained by unsupported assumptions and inappropriate methodologies, including:

- None of the taxpayer studies target the loss discount to MCC's historical loss of approximately 4 basis points. That is, its customers had historically paid approximately 99.96 percent of the time. See **Table 7**. The taxpayer studies base its discount not on recent historical results for the same discount, but rather by making a relatively complex, multi-step calculation related to the long-term/overall financial viability of certain customers relative to the returns on risk-free investments.[38, 39] Such calculations—even if performed correctly—represent an inappropriate comparison to the

[37] Lowering the TD DISCOUNT STUDY's and the PWC DISCOUNT STUDY's loss discount would reduce the discount spread by 19 to 41 basis points. See **Table 7**. Multiplying these amounts by the total amount of MCC receivables transferred to MIH during the period at issue (approximately $2.2 billion) results in a reduction of the total discount claimed by MCC of between $4 million and $9 million.

[38] In this context, for example, the PWC DISCOUNT STUDY estimates that A&P will refuse to pay for products more than 0.50 percent of the time despite the fact that: (1) no evidence has been provided that A&P ever refused to pay for *any* product from MCC; and (2) this rate is more than ten times the historical losses that MCC suffered from all customers. McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix C.

[39] However, this is essentially comparing apples to oranges in a situation where the historical value of apples is already known. In that sense, the long-term risks of operations for MCC customers presumably measure their likelihood of long-term operations, not their likelihood of making good on current payables in the next 30 or 60 days. This concept is summarized in Bothwell, Robert. (November/December 2007). "Trade Receivables Risk: An Insider Perspective." Global Association of Risk Professionals. Iss. 39, p. 6.

losses that MCC would expect in the short-term from its customers.[40]

- The taxpayer uses 180 day to 1 year term to maturity yield spreads to represent securities that had an average maturity (DSO) of only approximately 30 days. Since spreads increase with maturity length,[41] the taxpayer's method results in an upward bias.

4. Servicing Discount & Costs

The taxpayer models these transactions as having: (a) MIH *receiving* (from MCC) a discount to cover the arm's length costs of finding (and paying) someone to service the receivables; and (b) MIH *paying* (to MCC) an arm's length fee to cover said services. Of course, as the two payments should essentially cover the *same* services (the arm's length cost of servicing) and they flow in *opposite* directions, they should "net" to a *zero* payment. In fact, modeling these two payments as a single net payment of zero is a simpler/more accurate approach. However, one could also choose to value the servicing costs in the discount rate *and* have the same payment for servicing fees.

The taxpayer's application diverts from arm's length levels because it suggests that a receivable buyer (MIH) would receive a servicing discount of approximately *five times* its servicing costs. Whether the servicing discount or the service fee (or neither) is consistent with arm's length expectations is relatively unimportant. Rather, the entire payment structure would be consistent with arm's length expectations only if the two were essentially equal (cancelled each other out). This "uplift" by the taxpayer's studies to an arm's length servicing fee translates to approximately $11 million of additional income to MIH—and/or losses to MCC.[42]

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[40] Mathematically, the calculation does not incorporate the profit maximizing behavior that would be expected of MCC. That is, if a customer chose not to pay a bill, MCC would likely not continue to engage in business with that customer. In that case, that customer's share of MCC's sales would quickly decline. That is, MCC's risk is minimized by its ability to sell to other customers or stop selling to a non-payer.

[41] Litterman, Robert and Iben, Thomas. (1991). "Corporate Bond Valuation and The Term Structure of Credit Spreads," Journal of Portfolio Management. Spring 1991, Vol. 17, No. 3, pp. 52-64.

[42] That is, 51.8 basis points multiplied by approximately $2.2 billion.

5. Minor Critiques of Taxpayer's Proposed Discount Rate

Both the TD DISCOUNT STUDY and the PWC DISCOUNT STUDY make inappropriate assumptions/calculations that have relatively minor impacts on their calculated discount rates, including:

- **PWC DISCOUNT STUDY Range**: The PWC DISCOUNT STUDY does not employ a range covering a "minimum through maximum," but rather generally an "average through maximum."[43]

- **Added Buffers**: Both taxpayer studies apply unsupported "buffers" to increase various components of the discount rate including: (1) days sales outstanding;[44] (2) loss discount;[45] and (3) prompt payment discount.[46]

- **Accrued Rebate Discount**: Although MIH purchases the receivables, it is still MCC's obligation to pay its customers' volume rebates. Both taxpayer studies add minor risk premiums to account for the potential of customers netting these volume rebates against accounts receivables for concern about MCC's ability to pay such rebates. While such a situation would generally be unlikely, its likelihood is further minimized by the RSA allowing MIH to terminate the agreement should McKesson Corporation's S&P credit rating fall below BBB- or because of adverse

[43] For example, the PWC DISCOUNT STUDY uses the *average* of accrued rebates discounts as the low end of the range while using the *maximum* as the high end of the range. McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix J.

[44] The PWC DISCOUNT STUDY's high end of the DSO range uses the average DSO multiplied by 1.2. This results in a higher DSO (38.1 days) than the maximum annual DSO reported over the past three years (32.5 days) for MCC. See **Table 9**.

[45] The TD DISCOUNT STUDY uses the top one percent (addition of three standard deviations) of the one month historical loss data to MCC for the loss discount for Other Obligors. Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., pp. 7-8.

[46] The TD DISCOUNT STUDY adds to the prompt payment discount a buffer of 20 percent, and the PWC DISCOUNT STUDY adds a buffer of 5 percent to its high end of the range. Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., p. 7; and McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, pp. 12-13.

events.[47] That is, MIH could terminate the RSA well in advance of MCC defaulting on the volume rebates, limiting any exposure to this risk.

[47] That is, MIH may terminate the RSA if there are any events that generally "materially adversely affects" MIH. McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," pp. 18-19.

V. Affirmative Valuation

A. Overview

In this chapter, I consider and perform various analyses to determine the prices that would result in hypothetical arm's length sales (and servicing) of receivables under the circumstances defined in **Table 3**. Based upon the analysis below (and/or alluded to in Chapter IV), I determine that at arm's length:

- The "net" discount (inclusive of paying back a servicing fee) would be approximately 0.8386 percent; and
- The net discount rate would have yielded MCC approximately $27.0 million *more* profit in Canada than it proposed in 2003. See **Table 16**.

B. Key Facts to Consider

In understanding the potential results of negotiations between unrelated parties, it is useful to understand key aspects of the transaction between the parties, including:

- **Underlying Assets**: While MIH entered into a five year agreement with MCC, the underlying assets (receivables) are short term debt obligations (historically paid on average after approximately 30 days). See **Table 9**.
- **MIH Credit Risk**: The RSA shifts short term credit risk related to the MCC obligors from MCC to MIH. However, MIH has limited its credit risk through the RSA termination events, and policies and procedures related to accounts receivables. That is, MIH can refuse to buy certain receivables should they not qualify as eligible or terminate the RSA should MCC's credit risks become too high.[48]
- **Servicing**: MCC will continue to service the transferred receivables. In that sense, MIH must pay MCC a servicing fee—directly or indirectly—through a higher price (lower discount) for receivables.

[48] MIH can, if it chooses, terminate the RSA for reasons related to (negative) changes in MCC's receivables: (1) MCC's delinquency ratio exceeding 2.5 percent; (2) MCC's loss ratio exceeding 0.25 percent; and (3) McKesson Corporation's long term credit rating falling below Baa3. McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," pp. 17-18; and McKesson Canada Corporation and McKesson International Holdings III S.ar.l. (3 December 2003). "Procedure Manual Accounts Receivable Purchase Program," Annex D.

C. Transfer Pricing Methodologies and Results

In determining the transfer prices that would exist at arm's length, I focus on economic theory and overall logic. That is, I apply the most direct evidence related to pricing as possible. In particular, benchmark prices and overall profitability levels would potentially apply different levels of directness/precision to price the hypothetical transaction defined in **Table 3**. Theoretically, economic logic suggests the following type of reasoning with regard to these two types of benchmarks:

- Arm's length evidence of a *price* in an actual transaction for the same/quantifiably similar receivables under similar circumstances would logically provide the most direct benchmark in estimating the arm's length price (discount) among *hypothetical* arm's length parties.[49] The Organisation for Economic Co-operation and Development ("OECD") refers to this as the Comparable Uncontrolled Price ("CUP") Method.[50]

- When reasonable transactional benchmarks are not available and/or as an alternative approach, one can also benchmark prices/discounts by setting the parties to benchmark profitability levels.[51] That is, the logic follows that *prices* consistent with arm's length expectations lead to *profits* consistent with arm's length expectations. These approaches work "backwards" from that logic by first setting one (or both) entity's profit levels to the levels earned by similar independent firms. This approach then allows one to essentially "solve for" the transfer price that will result in such arm's length profit levels. The two profitability methods defined by the OECD are the Transactional Net Margin Method ("TNMM") and the Profit Split Method.[52]

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[49] Such pricing may provide a full discount rate or only certain components thereof.

[50] Organisation for Economic Co-operation and Development. (August 1997). Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, p. II-2. It should be mentioned that I footnote the OECD Guidelines for reference purposes only. I rely exclusively on my experience as an economist and my assignment to determine arm's length pricing in shaping my conclusions.

[51] Profitability approaches also have the advantage of implicitly "covering" multiple relationships/transactions between two related parties (*e.g.*, receiving a servicing discount *and* paying a servicing fee, etc.) in a single approach, when applicable. That is, the sum total of the related party transfers could potentially be analyzed as arm's length depending on overall resulting profitability.

[52] Organisation for Economic Co-operation and Development. (August 1997). Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, pp. III-1 and III-9.

While the above ordering is consistent with economic logic, there exist certain constraints imposed by data. That is, while transactional benchmark approaches might appear to be theoretically more direct/superior, in practice, closely matching/relatively "exact" [53] transactional benchmark data under similar market forces/circumstances are not often available. As such, practitioners in this field analyze relatively inexact transactions and overall profitability approaches more often than would likely be expected given the ordering above.[54]

I consider the above logic in determining the best method(s)[55] for the hypothetical arm's length prices at issue. The best method in any potential case is a *relative* measure in comparing the reliability/directness/precision of its arm's length data to the corresponding data in a potentially competing method. Thus, a particular method would not be classified as absolutely "correct" or "incorrect", but rather better or worse than other options.

1. Approaches Applied and Considered

a. Build-Up Approach

I implement a (net) build-up approach similar to that performed by the taxpayer in the TD DISCOUNT STUDY and PWC DISCOUNT STUDY. Essentially, this approach provides a discount rate based on the time value of money and the potential for *not* collecting some (or all) of the face value receivables being sold.

The risk free rate represents a charge for foregoing the use of funds over the holding period—that is, the time value of money. This rate is often benchmarked against government obligations with a similar maturity.[56] I use the 30-day CDOR (2.79 percent on December 10, 2002) as the risk free rate, adjusted for DSO.

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[53] Of course, there is no definitive distinction between exact and inexact transactional comparables. Rather, there is a continuum of relevance/accuracy ranging from a perfect match requiring no adjustments, to a transaction with almost no likeness that will require significant adjustments and assumptions. I use the terms exact and inexact to help simplify the discussion in the main text above.

[54] I make this point not to justify the approaches used in this field, but merely to point out that transfer pricing is a mixture of economic theory and practical data analysis.

[55] As would be expected, choosing the best method(s) is standard practice in economic analysis. The OECD describes this choice as being dependent on the facts and data at issue. Organisation for Economic Co-operation and Development. (August 1997). Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators, pp. I-26 and I-27.

[56] Pratt, Shannon P., Reilly, Robert F., and Schweihs, Robert P. (1996). Valuing a Business: The Analysis and Appraisal of Closely Held Companies. 3rd Edition. Irwin Professional Book Group: Chicago, pp. 162-163.

For the receivables sold, the DSO is simply a result of the historical DSO (30.2 days) of MCC's operations.[57] See **Table 9**. This translates to the yield rate component of the discount rate (product of the DSO and the *annual* yield rate) equaling 0.2309 percent. See **Table 10**.

The second component under this approach focuses on the risk of MCC's accounts receivable. The primary additional risk for short-term debt like accounts receivables is default—customers *not* paying.[58] Historically, MCC's customers consistently paid 99.9560 percent of the time. See **Table 7**. Thus, the loss discount component I apply is 0.0440 percent. See **Table 10**.

In addition to the premium risk, MCC also provides discounts for customers making early payments. If this occurs, the amount received from the obligor will be lower than the face value of the receivables. To account for this discount, I benchmark this prompt payment discount using MCC's historical average of 0.5324 percent of face value. That is, on average, its customers (that did not default) paid 99.4676 percent of face value. See **Table 13**. Combining the risk free rate, the credit risk and the prompt payment discount, I calculate a net discount rate of 0.8073 percent. See **Table 10** and below.[59]

Build-Up Approach Net Discount Rate: 2003

2003	**Percent of Accounts Receivable**	**Formula**
Yield Rate	0.2309%	A
Loss Discount	0.0440%	B
Prompt Payment Discount	0.5324%	C
Net Discount Rate	**0.8073%**	D = A+B+C

b. Comparable Transaction Approach

In the comparable transactional approach, I search for agreements that have similar characteristics to the hypothetical construct defined in **Table 3** including similar: (1) underlying

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[57] This DSO calculation does not include the initial sale of receivables from MCC to MIH which would have resulted in a slightly lower DSO figure. Rather, the average over the 2000-YTD P09 2003 period is utilized.

[58] Bodie Zvi, Kane, Alex, and Marcus, Alan J. (2002). Investments. McGraw-Hill Higher Education: Boston, Chapter 14.

[59] It should be re-emphasized that this is a "net" approach associated with the servicing in that it does not first provide MIH with a discount to pay for servicing (as part of a gross discount) and then charge it for the same servicing (in a service fee). While this net approach is *economically* apples to apples with the taxpayer's structure, it is a slightly different *format* than the taxpayer's structure. In that sense, a net discount of 0.8073 percent would essentially be the same as: (a) a gross discount of 0.9390 percent; and (b) a service fee of 0.1317 percent.

assets (*e.g.*, MCC's receivables); (2) risk profiles for the parties involved in the transaction; (3) terms (*e.g.*, non-recourse, etc.). The closer the agreement to the hypothetical, the higher degree of confidence I have in the benchmark agreement. As such, I focus my consideration of benchmark transactions to only those transactions involving MCC and a third party factor.

I was provided only one factoring agreement between MCC and a third party factor, TD Factors Limited and the Toronto-Dominion Bank ("TDF Agreement"). The TDF Agreement applied a discount rate based on a risk free rate, a spread, and a modest arrangement fee. See **Table 11**. To determine the similarity between the two agreements and the use of the TDF Agreement as a potential arm's length benchmark, I examine several key aspects of the agreements, including:

- **Historical Payment by Obligors**: The RSA and the TDF Agreement had similar risk in that they both involved MCC's receivables with an overlap in the list of obligors (different time periods).[60] The RSA may also have been more favorable (*i.e.*, *lower* discount) to the purchasing party in that the RSA allowed MIH an ability to end the transaction.[61]

- **Recourse vs. non-recourse**: Both the TDF Agreement and the RSA were non-recourse agreements.[62]

- **Servicing:** MCC serviced the accounts receivables as part of both agreements.[63]

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[60] Many of the same obligors were part of both factoring agreements including Pharma Plus Drugmarts, Loblaws Companies Limited, Zellers, and Canadian Safeway Limited. The overlap represented approximately 30 percent of the receivables at issue in the TDF Agreement. TD Factors Limited and The Toronto Dominion Bank and Medis Health and Pharmaceutical Services Inc. (1996). "Accounts Receivable Purchase Agreement," Schedule A; and McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," Schedule D.

[61] McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," pp. 17-18.

[62] TD Factors Limited and The Toronto Dominion Bank and Medis Health and Pharmaceutical Services Inc. (1996). "Accounts Receivable Purchase Agreement," p. 1; and McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," p. 7.

[63] TD Factors Limited and The Toronto Dominion Bank and Medis Health and Pharmaceutical Services Inc. (1996). "Accounts Receivable Purchase Agreement," p. 3; McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," p. 9; and McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement," p. 1.

- **Sale of Receivables Term**: The agreements covered receivables for (broadly) similar expected days sales outstanding.[64] See **Tables 9 & 11**.

- **Prompt Payment Discount:** The RSA includes the prompt payment discounts as part of the discount rate.[65] The TDF Agreement made no mention of this discount.

In **Table 12**, I apply the terms of the TDF Agreement to the RSA of 2002. These terms would essentially yield a "net" discount rate of 0.3376 percent. This is potentially an "apples to apples" comparison to the net discount rate to be applied in the RSA, with the possible exception of prompt payment discounts.

The TDF Agreement does not specify whether prompt payments are possible for the MCC receivables at issue, while they *are* clearly an issue in the RSA transaction being analyzed. Thus, I conservatively adjust the TDF Agreement's implied net discount rate to reflect the prompt payment discount. As stated previously, the historical (pre-RSA) prompt payment discounts for MCC customers were approximately 0.5324 percent. See **Table 13**. Adjusting for this discount, I determine an arm's length net discount rate of 0.8700 percent using the TDF Agreement.[66] See **Table 14**.

c. Profitability Approaches

I have chosen not to affirmatively apply any profitability approaches (*e.g.*, TNMM, profit split, etc.) in this case, as I believe other approaches offer clearer economic benchmark evidence of the prices that would be expected at arm's length between MCC and MIH. Instead, I consider these approaches as a test of reasonableness once I estimate my single point estimate for the arm's length discount rate for the RSA.

2. Single Point Estimate

The two forms of transactional approaches applied above—Build-Up and Comparable Transaction—resulted in similar arm's length transfer prices (net discount rates) of

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[64] I adjust for the differences that do exist.

[65] McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," p. 10; and Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., p. 10.

[66] Without the prompt payment adjustment, the arm's length net discount rate would simply be 0.3376 percent.

approximately 0.81 to 0.87 percent. Both approaches are based upon arm's length transactional benchmarks, although each approach uses a different set of transactional benchmarks to determine the arm's length discount. In deciding upon a single discount rate, I take the average of the two results of 0.8386 percent.[67] See **Table 15**.

Based on an arm's length net discount *rate* of 0.8386 percent, I calculate an arm's length discount on the sale of receivables to MIH of $18.3 million for 2003. The arm's length discount is approximately $27.0 million less than the discount proposed by the taxpayer. See **Table 16** and below. That is, the taxpayer's proposed discount results in approximately $27.0 million less profit for MCC than would be expected at arm's length.

BECKER Single Point Estimate Compared to Taxpayer's Proposed Prices

Adjustment ($ million, except percentages)	BECKER	Taxpayer	Difference	Formula
MCC's Sale of Net Accounts Receivables	$2,187.0	$2,187.0	--	A
Net Discount Rate[68]	0.8386%	2.0745%	1.2359%	B
Net Discount on Sale of Receivables	$18.3	$45.4	$27.0	C = A*B

3. Tests of Reasonableness

The transactional approaches above leading to a net discount of 0.8386 percent can be compared to various financial information from MCC. A comparison of the pre- and post-RSA finance charges provides some reasonable test for the discount rate applied, but the test is not exact because MCC may account for some components of the discount (*i.e.*, prompt payment, etc.) in different "line items" of their income statements. In that sense, a comparison of resulting (pre-tax) *profit* levels allows one to consider these various components. As seen below and in **Table 17**, the arm's length discount rate that I have calculated results in a pre-tax profit margin (1.1 percent) that is similar to pre-RSA levels (0.6 to 1.3 percent), while the taxpayer's proposed discount places MCC in a unique *loss* position.

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[67] It should be re-emphasized that this is a "net" approach associated with the servicing in that it does not first provide MIH with a discount to pay for servicing (as part of a gross discount) and then charge it for the same servicing (in a service fee). While this net approach is *economically* apples to apples with the taxpayer's structure, it is a slightly different *format* than the taxpayer's structure. In that sense, a net discount of 0.8386 percent would essentially be the same as: (a) a gross discount of 0.9703 percent; and (b) a service fee of 0.1317 percent. See **Table 15**.

[68] The corresponding gross discount rates would be 0.9703 percent and 2.2062 percent. That is, the Difference would remain the same.

Test of Reasonableness: MCC's Profitability 2003 (Post-RSA)[69]

Financial Items (As a Percent of Sales)	Taxpayer's Proposed Prices	Becker Arm's Length Calculation	MCC: 2000-2003 (Pre-RSA)
Pre-Tax Profit Margin	**Negative 0.5%**	**1.1%**	**0.6 to 1.3%**

These comparisons do not affirmatively "prove" the correctness of the calculated transfer prices. However, they do allow these calculated transfer prices to pass this test of reasonableness.

[69] The calculation of the taxpayer's proposed prices and my arm's length calculation include a finance charge for initial receivables not in sales base for that period. Without such receivables, MCC would have reported pre-tax profit margins of approximately 0.1 percent and the pre-tax margin for my calculations would be approximately 1.8 percent.

McKesson Canada Transfer Pricing Report

TABLES

Sale of Receivables Background: Tables 1A-3

Table 1A:

McKesson's Proposed Transfer Prices

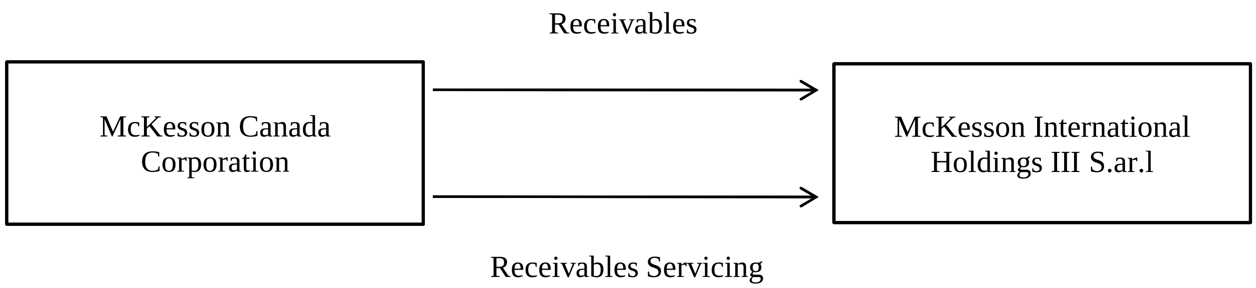
Proposed Transfer Prices (CAD million, except percentages)	**2003**	**Formula**	**Source**
Gross Discount on Receivables Purchased by MIH			
Face Value of MCC's Accounts Receivables Sold to MIH	$2,187.0	a	(1)
Gross Discount on Sale of Receivables /1/	$48.3	b	(2)
Gross Discount Rate	**2.2062%**	c = b/a	Calculation
Total Services Fees Paid to MCC	$2.9	d	(3)
Total Service Fees Paid to MCC as a Percent of Receivables	0.1317%	e = d/a	Calculation
Net Discount Received by MIH			
Net Discount (Gross Discount Less Service Fee)	$45.4	f = b-d	Calculation
Net Discount as a Percentage of Accounts Receivable	**2.0745%**	g = f/a	Calculation
Net Payment by MIH for **Receivables and Servicing**	$2,141.6	h = a-f	Calculation

Note:
/1/: MIH's financial statements for the period ending March 31, 2003 show a lower discount of $45.8 million.

Sources:
(1) McKesson Canada Corporation. (2003). "Reconciliation to T106: FY03." Alternatively known as Document December 15, 2009, Tab 34.
(2) McKesson Canada Corporation. (2003). "Amended Statement of Earnings As of 29 March 2003." Alternatively known as Document R-70.
(3) McKesson International Holdings III S.ar.l. (2003). "Financial Statements for the Period from September 25, 2002 (Date of Incorporation) to March 31, 2003," p. 9. Alternatively known as Document R-130.

Table 1B:

Flow of Intercompany Transactions Between MCC and MIH



Sources:
(1) McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," pp. 1, 7.
(2) McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement," pp. 1, 2.

Table 2:

Characteristics of the Actual Transactions Between MCC (Seller) and MIH (Purchaser)

Characteristics	MCC	MIH	Source
Transactions			
Intercompany Transaction at Issue	Sale of MCC Eligible Receivables	Purchase of MCC Eligible Receivables	(1)
Intercompany Transaction at Issue	Provide Servicing on Receivables	Receive Servicing on Receivables	(1) & (2)
Timing of Intercompany Transactions	Concurrent	Concurrent	(1) & (2)
Time Period	December 16, 2002 - March 29, 2003	December 16, 2002 - March 31, 2003	(1) & (4)-(5)
Accounts Receivable Sold/Purchased in 2003	More Than $2 Billion	More Than $2 Billion	Table 1A
Facility Limit for Accounts Receivable	$900 Million	$900 Million	(1)
Historic Days Sales Outstanding	30.2	N/A	Table 9
Historic Loss Average	0.0440%	N/A	Table 7
Historic Average Prompt Payment Discount	0.5324%	N/A	Table 13
Major Characteristics of Parties			
Description	Canadian Subsidiary of Multinational	Luxembourg Subsidiary of Multinational	(3) & (4)
Ultimate Parent	McKesson Corporation	McKesson Corporation	(3) & (4)
Other Transactions with Related Parties?	Yes	Yes	(3) & (4)
Financial Results Primarily Related Party Transactions?	No	Yes	(3) & (4)
Year of Incorporation	1905	2002	(3) & (4)
Operations	Wholesale Distribution of Healthcare Products	Financing Accounts Receivables	(3) & (4)
Financial Results			
Financial Results of Company:			
Historical Pre-Tax Income Margin	0.6% to 1.3%	N/A /1/	Table 4A
Consolidated Financial Results of Ultimate Parent: 2003 (USD Million)			
Sales	57,120.8	57,120.8	Table 5A
Pre-Tax Income	933.0	933.0	Table 5A
Assets	14,361.1	14,361.1	Table 5B
Equity	4,525.5	4,525.5	Table 5B

Note:
/1/: MIH's financial statements include reported transfer prices, as most of MIH's transactions occur with related parties.

Sources:
(1) McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement."
(2) McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement."
(3) Retrieved 15 June 2009 from http://mckesson.ca/en/mckesson.ca/history.aspx.
(4) McKesson International Holdings III S.ar.l. (2003). "Financial Statements for the Period from September 25, 2002 (Date of Incorporation) to March 31, 2003", pp. 4, 7-8. Alternatively know as Document R-130.
(5) McKesson Canada Corporation. (2003). "Amended Balance Sheet As of 29 March 2003." Alternatively known as Document R-70.

Table 3:

Characteristics of the Hypothetical Transactions Between Arm's Length Seller and Purchaser

Characteristics	Multinational A (Seller)	Multinational B (Purchaser)
Transactions		
Intercompany Transaction at Issue	Sale & Service of Multinational A's Eligible Receivables	Purchase of Multinational A's Eligible Receivables
Intercompany Transaction at Issue	Provide Servicing on Receivables	Receive Servicing on Receivables
Timing of Intercompany Transactions	Concurrent	Concurrent
Time Period	December 16, 2002 - March 29, 2003	December 16, 2002 - March 31, 2003
Accounts Receivable Sold/Purchased in 2003	More Than $2 Billion	More Than $2 Billion
Facility Limit for Accounts Receivable	$900 Million	$900 Million
Historic Days Sales Outstanding	30.2	N/A
Historic Loss Average	0.0440%	N/A
Historic Average Prompt Payment Discount	0.5324%	N/A
Major Characteristics of Parties		
Description	Canadian Subsidiary of Multinational	Luxembourg Subsidiary of Multinational
Ultimate Parent	Parent of Multinational A	Subsidiary of Multinational B
Other Transactions with Related Parties?	Yes	Yes
Financial Results Primarily Related Party Transactions?	No	Yes
Year of Incorporation	1905	2002
Operations	Wholesale Distribution of Healthcare Products	Financing Accounts Receivables
Financial Results		
Financial Results of Company:		
Historical Pre-Tax Income Margin	0.6% to 1.3%	N/A
Consolidated Financial Results of Ultimate Parent: 2003 (USD Million)		
Sales	57,120.8	57,120.8
Pre-Tax Income	933.0	933.0
Assets	14,361.1	14,361.1
Equity	4,525.5	4,525.5

Financial Statements: Tables 4A-5B

Table 4A:

MCC Income Statement: 2000-2003

In CAD million (except percentages)	2000	2001	2002	2003 Pre-RSA	2003 Post-RSA /1/	Formula
Total Net Sales /2/	$3,262.2	$3,987.7	$4,522.3	$3,593.0	$1,622.8	a
Cost of Sales /3/	$3,135.0	$3,842.0	$4,361.0	$3,471.7	$1,536.6	b
Selling Margin	$127.2	$145.7	$161.4	$121.3	$86.2	c = a-b
Buying/Holding Margin	$46.3	$53.2	$68.7	$51.6	N/A	d
Net Margin	$173.5	$198.9	$230.0	$172.9	$86.2	e = c+d
Operating Expenses	$138.4	$154.1	$163.5	$120.0	$46.8	f
Corporate Expenses	$0.5	$0.2	$0.2	$0.5	N/A	g
Operating Profit	$34.6	$44.6	$66.3	$52.5	$39.4	h = e-f-g
Operating Margin	1.1%	1.1%	1.5%	1.5%	2.4%	i = h/a
Finance Charges /4/, /5/	$14.1	$13.6	$11.8	$7.3	$48.3	j
Finance Charges As Percentage of Sales	**0.4%**	**0.3%**	**0.3%**	**0.2%**	**3.0%**	k = j/a
Pre-Tax Income	$20.6	$31.0	$54.5	$45.2	($8.8)	l = h-j
Pre-Tax Margin	**0.6%**	**0.8%**	**1.2%**	**1.3%**	**-0.5%**	m = l/a

Notes:
/1/: I estimate the income for the Post-RSA Agreement period by using periods 10 through 13 (after amalgamation only) in the submitted financial documentation.
/2/: "Nets" out cash discounts, rebates, etc.
/3/: Recorded as cost of sales and operating expenses for Post-RSA figure.
/4/: Includes charges for (initial) sales accrued prior to Post-RSA period. Without these charges, the pre-tax margin would be approximately 0.1 percent.
/5/: Recorded as discount on sale of receivables for Post-RSA figure.

Sources:
(1) Medis Health and Pharmaceutical Services Inc. (10 April 2001). "Statement of Income, Market Segment - All." Alternatively known as Document R-58.
(2) Medis Health and Pharmaceutical Services Inc. (22 August 2002). "Statement of Income, Market Segment - All." Alternatively known as Document R-59.
(3) McKesson Canada Corporation. (18 December 2002). "Statement of Income, Market Segment - All." Alternatively known as Document R-60.
(4) McKesson Canada Corporation. (2003). "Amended Statement of Earnings As of 29 March 2003." Alternatively known as Document R-70.

Table 4B:

MCC Balance Sheet: 2000-2003

In CAD million (except percentages)	2000	2001	2002	13-Dec-02	29-Mar-03 /1/	Formula
Cash	$0.0	$50.2	$48.3	$114.2	$32.7	a
AR Trade	**$289.4**	**$342.4**	**$380.2**	**$477.3**	**$5.1**	b
Allowance for Bad Debt	($2.9)	($3.5)	($3.1)	--	--	c
AR Other	$17.3	$19.3	$27.6	--	--	d
AR Intercompany	--	--	$23.4	--	$0.0	e
Inventories	$276.9	$315.1	$353.6	$494.6	$365.6	f
Prepaid Expenses	$3.2	$3.9	$5.0	$3.9	$3.0	g
Income Tax Receivables	--	--	--	--		h
Total Current Assets	$583.9	$727.3	$835.0	$1,089.9	$406.4	i = sum(a:h)
Total Fixed Assets	$35.2	$40.2	$38.7	$36.3	$35.7	j
Other Assets	$25.9	$24.7	$27.0	$22.8	$114.5	k
Investment and Long-Term Receivables	$0.1	$4.2	$4.8	$21.2	$19.6	l
Total Assets	**$645.2**	**$796.4**	**$905.5**	**$1,170.2**	**$576.2**	m = sum(i:l)
Outstanding Cheques/Deposits	$21.4	$37.9	$13.7	$23.5	--	n
Bank Loan	($10.2)	$0.0	$0.0	--	--	o
Loan McKesson	$175.3	$22.0	$175.3	--	--	p
Accounts Payable Trade	$343.5	$389.6	$466.7	--	--	q
Accrued Liabilities	$31.3	$54.9	$54.5	--	--	r
Accounts Payable Trade & Accrued Liabilities	$374.8	$444.5	$521.2	$762.7	$570.2	s
Accounts Payable Intercompany	$0.0	$2.1	$2.5	$2.0	$2.0	t
Income Tax Payable	($0.0)	$3.3	$10.7	$17.5	$5.4	u
Total Current Liabilities	$561.2	$509.7	$723.4	$805.6	$577.6	v = n+o+p+s+t+u
Current Capital Lease Obligations	$0.0	$0.0	$0.0	($0.0)	--	w
Long-Term Capital Lease Obligations	$0.0	$0.0	$0.0	--	--	x
Long-Term Debt	$0.5	$173.8	$100.6	--	--	y
Total Long-Term Liabilities	$0.5	$173.8	$100.6	($0.0)	$0.0	z = sum(w:y)
Deferred Taxes	$5.4	$8.0	$11.5	$5.4	$2.1	aa
Total Equity	**$78.1**	**$104.9**	**$70.0**	**$359.2**	**($3.5)**	ab
Liabilities & Equity	$645.2	$796.4	$905.5	$1,170.2	$576.2	ac = v+z+aa+ab

Note:
/1/: For the Balance Sheet as of March 29, 2003, Cash also includes "Bank investments."

Sources:
(1) Medis Health and Pharmaceutical Services Inc. (26 June 2001). Balance Sheet. Alternatively known as Document R-58.
(2) Medis Health and Pharmaceutical Services Inc. (25 April 2002). Balance Sheet. Alternatively known as Document R-59.
(3) McKesson Canada Corporation. (13 December 2002). Consolidated Balance Sheet As at 13 December 2002. Alternatively know as Document R-67.
(4) McKesson Canada Corporation. (2003). "Amended Balance Sheet As of 29 March 2003." Alternatively known as Document R-70.

Table 5A:

McKesson Corporation Consolidated Income Statement: 2000-2003

In USD Million (except percentages)	2000	2001	2002	2003	Formula
	For Fiscal Year Ended March 31,				
Revenues	36,708	42,000	49,988	57,121	a
Cost of Sales	34,485	39,583	47,200	54,018	b
Gross Profit	2,223	2,417	2,789	3,103	c = a-b
Percent of Revenues	6.1%	5.8%	5.6%	5.4%	d = c/a
Operating Expenses	2,114	2,212	2,087	2,170	e
Operating Income	110	205	701	933	f = c-e
Percent of Revenues	0.3%	0.5%	1.4%	1.6%	g = f/a
Interest Expense	(114)	(111)	(126)	(128)	h
Gain (Loss) on Investments, Net	269	(121)	(14)	1	i
Other Income, Net	49	42	40	45	j
Income Before Tax	313	15	602	851	k = f+sum(h:j)
Pre-Tax Profit Margin	0.9%	0.0%	1.2%	1.5%	l = k/a

Sources:

(1) McKesson Corporation. (10 June 2004). Form 10-K for the Fiscal Year Ended 31 March 2004, p. 55.

(2) McKesson Corporation. (6 June 2003). Form 10-K for the Fiscal Year Ended 31 March 2003, p. 54.

(3) McKesson Corporation. (12 June 2002). Form 10-K for the Fiscal Year Ended 31 March 2002, p. 50.

Table 5B:

McKesson Corporation Consolidated Balance Sheet: 2000-2003

In USD Million (except percentages)	For Fiscal Year Ended March 31, 2000	2001	2002	2003	Formula
Assets					
Cash and Cash Equivalents	548.9	433.5	557.8	522.0	a
Marketable Securities	57.0	11.9	5.1	11.5	b
Receivables, Net	3,034.5	3,439.4	3,998.1	4,594.7	c
Inventories	4,149.3	5,116.4	6,011.5	6,022.5	d
Prepaid Expenses	175.8	157.3	128.6	102.9	e
Current Assets	7,965.5	9,158.5	10,701.1	11,253.6	f = sum(a:e)
Property, Plant and Equipment, Net	555.4	594.2	593.5	593.7	g
Capitalized Software Held for Sale	92.2	103.7	118.4	131.1	h
Notes Receivable	100.9	131.3	237.7	245.6	i
Goodwill and Other Intangibles	1,185.6	1,064.4	1,115.7	1,449.5	j
Other Assets	473.3	479.9	559.5	687.6	k
Total Assets	10,372.9	11,532.0	13,325.9	14,361.1	l = sum(f:k)
Liabilities and Stockholders' Equity					
Drafts and Accounts Payable	3,883.9	5,338.3	6,318.3	6,482.8	m
Deferred Revenue	368.7	399.8	404.1	459.7	n
Current Portion of Long-Term Debt	16.2	194.1	141.3	10.2	o
Salaries and Wages	115.5	141.7	181.3	217.2	p
Taxes	354.8	79.6	121.7	221.3	q
Other	382.7	393.5	421.6	584.0	r
Current Liabilities	5,121.8	6,547.0	7,588.3	7,975.2	s = sum(m:r)
Postretirement Obligations and Other Noncurrent Liabilities	245.7	260.3	312.7	363.5	t
Long-Term Debt	1,243.8	1,035.9	1,288.7	1,496.9	u
Preferred Shares	195.8	195.9	196.1	0.0	v
Total Liabilities	6,807.1	8,039.1	9,385.8	9,835.6	w = sum(s:v)
Common Stock	2.8	2.9	2.9	2.9	x
Additional Paid-In Capital	1,791.1	1,828.7	1,831.0	1,921.2	y
Other Capital	(126.1)	(108.4)	(94.9)	(92.5)	z
Retained Earnings	2,122.3	2,006.6	2,357.2	2,843.3	aa
Accumulated Other Comprehensive Losses	(97.1)	(75.0)	(81.6)	(59.1)	ab
ESOP Notes and Guarantees	(99.9)	(89.0)	(74.5)	(61.7)	ac
Treasury Shares, At Cost	(27.3)	(72.9)	0.0	(28.6)	ad
Total Stockholders' Equity	3,565.8	3,492.9	3,940.1	4,525.5	ae = sum(x:ad)
Total Liabilities and Stockholders' Equity	10,372.9	11,532.0	13,325.9	14,361.1	af = w+ae

Sources:
(1) McKesson Corporation. (10 June 2004). Form 10-K for the Fiscal Year Ended 31 March 2004, p. 56.
(2) McKesson Corporation. (6 June 2003). Form 10-K for the Fiscal Year Ended 31 March 2003, p. 55.
(3) McKesson Corporation. (12 June 2002). Form 10-K for the Fiscal Year Ended 31 March 2002, p. 51.

Economic Evaluation of Taxpayer Studies: Tables 6-9

Table 6:

Summary of Taxpayer Approaches to Determining Discount Rate: 2003

Components of Discount Rate (Percent of Total Receivables) /1/	TD DISCOUNT STUDY	PWC DISCOUNT STUDY		Formula	Source
		Low	High		
Yield Rate	0.2424%	0.2169%	0.2602%	a	(1) & (2)
Loss Discount	0.2300%	0.3807%	0.4568%	b	(1) & (2)
Servicing Discount	0.6500%	0.2103%	0.2256%	c	(1) & (2)
Prompt Payment Discount	0.6000%	0.5000%	0.5250%	d	(1) & (2)
Accrued Rebate Dilutions Discount	0.0244%	0.0100%	0.0146%	e	(1) & (2)
Cost of Capital Discount	0.4564%	0.6520%	0.7824%	f	(1) & (2)
Gross Discount Rate	**2.2029%**	1.9698%	2.2646%	g = sum(a:f)	Calculation
Servicing Fee	0.1317%	0.1317%	0.1317%	h	Table 1A
Net Discount Rate	**2.0712%**	**1.8381%**	**2.1329%**	i = g-h	Calculation
Stated for Use by Taxpayer?	**Yes**	No	No	--	(3)
Net Discount Rate Actually Applied by Taxpayer	**2.0745%**				Table 1A

Note:
/1/: I show figures as reported in the taxpayer's reports.

Sources:
(1) Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., p. 10.
(2) McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix O.
(3) McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement," pp. 2, 6, 9.

Table 7:

MCC's Historical Losses As a Percent of Sales (In CAD Million): 2000-2003

Fiscal Year	MCC Consolidated Write-Off /1/	MCC Net Sales	Consolidated Write-Off As Percent of Sales	Source
2000	$2.1	$3,322.7	0.0636%	(1) & (5)
2001	$2.7	$4,071.8	0.0662%	(2) & (6)
2002	$1.2	$4,618.4	0.0252%	(3) & (7)
2003 /2/	$0.9	$3,677.2	0.0254%	(4) & (8)
Average Losses (Discounts)	$1.7	$3,922.5	**0.0440%**	Calculation
Level Applied by Taxpayer Studies	**--**	**--**	**0.2300% to 0.4568%**	Table 6

Notes:
/1/: Consolidated write-off includes all write-offs, adjustments made for bad debt provision, and other recoveries.
/2/: YTD P09 2003.

Sources:
(1) McKesson Canada Corporation. (4 December 2009). Detailed Departmental Expense Analysis for the Fiscal Year Ended 2000, p. 2.
(2) McKesson Canada Corporation. (4 December 2009). Detailed Departmental Expense Analysis for the Fiscal Year Ended 2001, p. 2.
(3) McKesson Canada Corporation. (4 December 2009). Detailed Departmental Expense Analysis for the Fiscal Year Ended 2002, p. 2.
(4) McKesson Canada Corporation. (15 June 2010). "Responses to Respondent's Follow-Up Questions," p. 10.
(5) McKesson Pharmaceutical. (11 March 2009). Actual Statement of Income for the Fiscal Year Ended 2000, p. 1.
(6) McKesson Pharmaceutical. (11 March 2009). Actual Statement of Income for the Fiscal Year Ended 2001, p. 1.
(7) McKesson Pharmaceutical. (11 March 2009). Actual Statement of Income for the Fiscal Year Ended 2002, p. 1.
(8) McKesson Canada Corporation. (18 December 2002). "Statement of Income, Market Segment - All." Alternatively known as Document R-60.

Table 8:

TD DISCOUNT STUDY's and PWC DISCOUNT STUDY's Servicing Discount Calculation

Servicing Discount	TD DISCOUNT STUDY	PWC DISCOUNT STUDY Low	PWC DISCOUNT STUDY High	Formula	Source
Proposed Arm's Length Service Fee to MCC	0.2000%	0.1827%	0.1827%	a	(1) & (2)
Replacement Servicer Cost Estimate	0.4500%	0.0276%	0.0429%	b	(1) & (2)
Discount Applied to Cover Servicing Fees in Receivables Discount	**0.6500%**	0.2103%	0.2256%	c = a+b	Calculation
Service Fees Actually Paid by MIH to MCC	**0.1317%**	0.1317%	0.1317%	d	Table 1A
Ratio of Discount Applied to Fund Servicing as a Ratio to Service Fee Actually Paid	**4.9**	1.6	1.7	e = c/d	Calculation

Sources:
(1) Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., p. 10.
(2) McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix G.

Table 9:

MCC's Historical Days Sales Outstanding ("DSO") Statistics

Fiscal Year	Average Per Period (Days)	Source
2000	32.4	(1)
2001	30.5	(1)
2002	29.0	(1)
2003 /1/	28.9	(1)
Four Year Average /2/	**30.2**	Calculation
TD DISCOUNT STUDY Applied DSO	31.73	(2)
PWC DISCOUNT STUDY Applied DSO	31.73 to 38.08	(3)

Notes:
/1/: YTD P09 2003.
/2/: A three year average covering the 2000-2002 period would have yielded similar results.

Sources:
(1) Medis Health & Pharmaceutical Services Accounts Receivable Statistics Period 13, 2000-2003.
(2) Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc., p. 5.
(3) McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, pp. 5-6.

BECKER Affirmative Valuation: Tables 10-17

Table 10:

BECKER Arm's Length Net Discount Rate Based on Build-Up Approach

Discount Rate	Percent of Accounts Receivable	Formula	Source
Yield Rate /1/	0.2309%	a	Table 9, (1)
Loss Discount	0.0440%	b	Table 7
Prompt Payment Discount	0.5324%	c	Table 13
Net of Servicing Fee Discount and Servicing Fee Payment /2/	0.0000	d	Calculation
Net Discount Rate	**0.8073%**	e = a+b+c+d	Calculation

Notes:

/1/: Product of the Banker's Acceptance rate as of 10 December 2002 (2.79%) and the DSO (30.2 days).

/2/: Receivable owner contracts to perform services for receivable purchaser concurrent with the timing of the receivable purchase.

Source:

(1) Retrieved 9 September 2009 from http://www.bankofcanada.ca/cgi-bin/famecgi_fdps.

Table 11:

Comparison of the TDF Agreement and RSA Terms

Characteristics	TDF Agreement	RSA	Source
Transactions			
Intercompany Transaction at Issue	Sale of MCC Receivables	Sale of MCC Receivables	(1) & (2)
Intercompany Transaction at Issue	Servicing of MCC Receivables	Servicing of MCC Receivables	(1) & (2)
Closing Date of Agreement	1996	December 16, 2002	(1) & (2)
Recourse	None	None	(1) & (2)
Facility Limit	$99 Million	$900 Million	(1) & (2)
Collection Agent/Servicer	MCC	MCC	(1) & (2)
Term of Agreement/Historical Results (DSO) /1/	14-22 days	30.2 days	(3), (4) & Table 9
Historical Prompt Payment Discount	N/A	0.5324%	Table 13
Large Customers (Obligors) Include	Pharma Plus, Loblaws, Zellers, & Safeway	Pharma Plus, Loblaws, Zellers, & Safeway	(1) & (2)
Termination Events for Agreement Include:			
Delinquency Ratio Greater Than:	N/A	2.50%	(1) & (2)
Loss Ratio Greater Than	N/A	0.2500%	(1) & (2)
Seller's Parent Company Rating Below	N/A	BBB-	(1) & (2)
Adverse Material Event	N/A	Yes	(1) & (2)
Definition of Discount Rate Per Agreement			
Yield Rate Based on	Banker's Acceptance	--	(1) & (2)
Additional Annual Yield (Spread)	0.375%	--	(1) & (2)
Arrangement Fees	0.0317%	--	(1), (2), & (3)

Note:

/1/: Under the TDF Agreement, the term of the sale of receivables was set upon each sale of receivables. The examples of receivable sales under the TDF Agreement showed terms of 14 to 22 days.

Sources:

(1) McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). “Receivables Sale Agreement.”

(2) TD Factors Limited and The Toronto-Dominion Bank and Medis Health and Pharmaceutical Services Inc. (1996). "Accounts Receivable Purchase Agreement."

(3) Archibald, W.C. (21 March 1996). "Letter to Mr. Alain Vachon Regarding Accounts Receivable Purchase." TD Factors Limited.

(4) Todd S. (29 March 1996). "Letter to Mr. Alain Vachon Regarding Accounts Receivable Purchase." TD Factors Limited.

Table 12:

Arm's Length Net Discount (Potentially Exclusive of Prompt Payment) for MCC Receivables Transferred to MIH based on TDF Agreement Terms

2003	Percent of Accounts Receivable	Formula	Source
Annual Yield Rate Based on Banker's Acceptance /1/	2.79%	a	(1)
Annual Spread	0.375%	b	Table 11
Combined Annual Yield	3.17%	c = a+b	Calculation
Term (Days Sale Outstanding)	30.2	d	Table 9
Yield Over the DSO	0.2619%	e = c*d/365	Calculation
Loss Discount	0.0440%	f	Table 7
Arrangement Fees	0.0317%	g	Table 11
Net Discount Rate (Potentially Exclusive of Prompt Payment)	**0.3376%**	h = e+f+g	Calculation

Note:
/1/: Banker's Acceptance as of 10 December 2002.

Source:
(1) Retrieved 9 September 2009 from http://www.bankofcanada.ca/cgi-bin/famecgi_fdps.

Table 13:

Historical Prompt Payment Discounts Provided by MCC to Its Obligors (CAD Million)

Fiscal Year	Discounts (Canada)	Discounts (Quebec)	Discounts (Excluding Quebec)	Net Sales	Ratio of Discounts to Sales
2000	27.0	8.9	18.1	3,322.7	0.5454%
2001	32.7	11.6	21.1	4,071.8	0.5190%
2002	37.3	14.2	23.1	4,618.4	0.5003%
2003 /1/	30.1	8.9	21.2	3,677.2	0.5757%
				Weighted Average:	**0.5324%**
Formula	a	b	c = a-b	d	e = c/d
Source	(1)	(1)	Calculation	(1)	Calculation

Note:
/1/: YTD P09 2003.

Sources:
(1) McKesson Canada Corporation. (Undated). Document A-115.
(2) McKesson Canada Corporation. (15 February 2007). "Respondent's Document No. 1,000,079." Alternatively known as Document R-45.
(3) McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). "Factoring Review." PricewaterhouseCoopers, Appendix L.
(4) McKesson Canada Corporation. (Undated). Document February 8, 2010, Tab 57.
(5) McKesson Canada Corporation. (Undated). "Appellant's Response to Request to Admit Facts, Folder 69," p. 18.
(6) Medis Health and Pharmaceutical Services Inc. (10 April 2001). "Statement of Income, Market Segment - All." Alternatively known as Document R-58.
(7) Medis Health and Pharmaceutical Services Inc. (22 August 2002). "Statement of Income, Market Segment - All." Alternatively known as Document R-59.
(8) McKesson Canada Corporation. (18 December 2002). "Statement of Income, Market Segment - All." Alternatively known as Document R-60.

Table 14:

BECKER Arm's Length Total Net Discount Rate Based on TDF Agreement CUP

Discount Rate	Percent of Accounts Receivable	Formula	Source
Net Discount Rate (Potentially Exclusive of Prompt Payment)	0.3376%	a	Table 12
Prompt Payment Discount	0.5324%	b	Table 13
Total Non-Recourse Net Discount Rate	**0.8700%**	c = a+b	Calculation

Table 15:

BECKER Single Point Estimate of Net Discount Rate in Audit Period

Discount Rate	Percent of Accounts Receivable	Source
Build-Up CUP Approach	0.8073%	Table 10
TDF CUP Approach	0.8700%	Table 14
Becker Single Point Estimate of Net Discount Rate	**0.8386%**	Estimate
Servicing Fee Applied by Taxpayer in Audit Period	0.1317%	Table 1A
Implied **Gross** Discount Rate Using Taxpayer`s Servicing Fee	0.9703%	Calculation

Table 16:

BECKER Single Point Estimate Compared to Taxpayer's Proposed Prices: 2003 (CAD Million)

Post-RSA 2003	BECKER	Taxpayer	Difference	Formula	Source
MCC's Sale of Net Accounts Receivables	$2,187.0	$2,187.0	--	a	Table 1A
Net Discount Rate Applied /1/	0.8386%	2.0745%	1.2359%	b	Table 1A, 15
Net Discount on Sale of Receivables	$18.3	$45.4	**$27.0**	c = a*b	Calculation
Reported Taxable Income			**-$8.8**	d	Table 4A
Arm`s Length Taxable Income			**$18.2**	e = c+d	Calculation

Note:
/1/: The corresponding gross discount rates would be 0.9703%; 2.2062%; and 1.2359%. That is, the Difference would remain the same.

Table 17:

Test of Reasonableness: MCC's Profitability

MCC (In CAD million, except percentages)	Actual Range of Values for MCC: 2000-2003 (Pre-RSA)	Taxpayer's Proposed 2003 (Post-RSA) MCC Financial Statement	Becker Arm's Length 2003 (Post-RSA) MCC Financial Statement
Finance Charges	--	$48.3	$21.2
Percent of Sales	0.2% to 0.4%	3.0%	1.3%
Pre-Tax Profit	--	($8.8)	$18.2
Pre-Tax Profit Margin /1/	**0.6% to 1.3%**	**-0.5%**	**1.1%**
Source:	Table 4A	Table 4A	Table 16 & Calculation

Note:
/1/: Includes charges for (initial) sales accrued prior to Post-RSA period. Without these charges, the pre-tax margin would be approximately 0.1 percent proposed by the taxpayer and 1.8 percent for the Becker calculations.

APPENDICES

APPENDIX A

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- Prepared more than 400 transfer pricing reports for taxpayers, the IRS, the Australian Taxation Office, and the Canada Revenue Agency on a variety of issues, including tangible property, cost sharing, intangible property, intercompany loans, guarantee fees, and service fees.
- Served as a lead transfer pricing economic expert for the IRS in the largest tax dispute and settlement on record, GlaxoSmithKline Holdings (Americas) v. Commissioner of Internal Revenue.
- Provided expert witness testimony—supporting two written reports—in the Tax Court of Canada in the transfer pricing dispute of General Electric Capital Canada Inc. v. Her Majesty the Queen.
- Served as an economic expert witness in the first two major transfer pricing trials in Australia: Roche Products Pty Limited v. Federal Commissioner of Taxation and SNF (Australia) Pty Limited v. The Commissioner of Taxation of the Commonwealth of Australia.
- Submitted an expert witness report and provided testimony in United States Tax Court in a transfer pricing dispute.
- Prepared and defended expert reports quantifying damages and valuations in the contexts of anti-trust, patent infringement, trade secrets, executive compensation, and tax shelters.
- Provided testimony and economic reports involving catfish, various steel products, and pineapples in hearings before the U.S. International Trade Commission.
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EXPERT TESTIMONY, SUBMISSIONS AND HEARINGS

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17) "The Effects of Inflation on Cross-Country Profit Comparisons," *Tax Management Transfer Pricing Report*, Vol. 7, No. 3, June 3, 1998, pp. 77-82 (with B. Brooks).
18) "Quantifying Comparability for Applications in Economic Analysis: The Weighted Distance Method," *The Southwestern Journal of Economics*, Volume 2, Number 1, April 1997, pp. 128-141 (with K. Button).
19) "Minority Interests in Market Valuation: An Adjustment Procedure," *Business Valuation Review*, Volume 16, Number 1, March 1997, pp. 27-31.
20) "Capital Adjustments: A Short Overview," *Tax Management Transfer Pricing Report*, Vol. 5, No. 19, January 29, 1997, pp. 613-619.
21) "Multiple Approaches to Valuation: The Use of Sensitivity Analysis," *Business Valuation Review*, Volume 15, Number 4, December 1996, pp. 157-160.
22) "The Robin Hood Bias: A Study of Biased Damage Awards," *The Journal of Forensic Economics*, Volume 9, No. 3, Fall 1996, pp. 249-259.
23) "Three Technical Aspects of Transfer Pricing Practice: Distinguishing Methods, Using Statistical Ranges, and Developing Data Sets," *Tax Management Transfer Pricing Report*, Vol. 5, No. 4, June 19, 1996, pp. 97-103.
24) "The Final Transfer Pricing Regulations: The More Things Change, the More they Stay the Same," *Tax Notes*, Volume 64, #4, pp. 507-523, 1994 (with G. Carlson, et. al.).
25) "Philadelphia's Luxury Hotels: Boom or Bust?," *The Cornell Hotel and Restaurant Administration Quarterly*, Volume 33, #2, pp. 33-42, 1992.

PROFESSIONAL SEMINARS

"Double Irish, Dutch Sandwich, and Other Current Transfer Pricing Topics," Guest Lecturer at The Georgetown University Law School, November 4, 2010.

"Transfer Pricing," Guest Lecturer at The Georgetown University Law School, November 5, 2009.

“Fundamentals of Transfer Pricing,” Conference Chair, IIR Seminar, London, UK, October 29, 2008.

“Fundamentals of Transfer Pricing,” Speaker on Transfer Pricing Methods, IIR Seminar, London, UK, June 11, 2008.

“Transfer Pricing,” Guest Lecturer at The George Washington University Law School, March 26, 2008.

“Economics of Private Student Loans,” Speaker on the 2008 National Council of Higher Education Loan Programs Leadership Conference: As the Dust Settles, Sarasota, FL, January 9, 2008.

“Economists in Transfer Pricing: Intangibles, Audits, and APAs,” Council for International Tax Education, Inc.: U.S. Transfer Pricing Planning and Controversies, Houston, TX, October 15, 2007.

“New IRS Rules for Transfer Pricing of Services,” Strafford Publications Teleconference Speaker on Methods and Services Sharing Agreements, July 10, 2007.

“New IRS Rules for Transfer Pricing of Services,” Strafford Publications Teleconference Speaker on Methods and Services Sharing Agreements, May 8, 2007.

“Economists in Transfer Pricing: Intangibles, Audits, and APAs,” Council for International Tax Education, Inc.: U.S. Transfer Pricing Planning and Controversies, Washington, DC, April 23, 2007.

“Profitability and R&D for PhRMA,” Pharmaceutical Research and Manufacturers of America Conference, Charlottesville, VA, January 26, 2007.

“Economics of Mass Tort: Lead Paint,” Gerson Lehrman Group Seminar, New York, NY, November 16, 2005.

“Understanding the Issues Involved in the Valuation of Intangibles,” Transfer Pricing: Best Practices for Managing the Corporate Transfer Pricing Function, Infonex Seminar, San Francisco, CA, October 27, 2005.

“Maximizing Revenue, Minimizing Taxpayer Burden,” Emcee and Speaker for Discussion of “Revenue Matters,” National Press Club, Washington, DC, June 7, 2005.

“Intangible Valuation in Transfer Pricing,” Transfer Pricing Roundtable: Best in Class Practices for Companies, Infonex Seminar, New York, NY, May 25, 2005.

“Transfer Pricing Workshop,” Workshop Chair and Speaker, IIR Ltd., London, UK, April 25, 2005.

“The Steel Industry: An Automotive Supplier Perspective,” National Press Club, Washington, DC, February 16, 2005 (with Kevin Hassett.)

“Probability and Statistics,” Digital Sandbox Risk Analysis Seminar Series, Reston, Virginia, October 14, 2004.

"The Economics of Transfer Pricing: Independent Arm's Length Analysis," Council for International Tax Education: U.S. Transfer Pricing Planning & Controversies, New York, NY, August 16, 2004.

"Transfer Pricing Workshop," Workshop Chair and Speaker, IIR Ltd., London, UK, April 21, 2004.

"Economists in Transfer Pricing: Independence, Methodologies, and Case Study," Council for International Tax Education: U.S. Transfer Pricing 101, New York, NY, February 23, 2004.

"Profitability Analysis of NYSE Trading Specialists," American Enterprise Institute Seminar Series, Washington, DC, October 8, 2003.

"Economists in Transfer Pricing: Independence, Cost Sharing, and CPM Volume Effects," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, New York, NY, August 18, 2003.

"Economists in Transfer Pricing: Profit Splits, Volume Effects, Cost Sharing, and Real Options," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, Washington, DC, May 6, 2003.

"Economists in Transfer Pricing: Profit Splits, Volume Effects, Cost Sharing, and Real Options," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, Dallas, TX, March 24, 2003.

"Topics in Transfer Pricing and Valuation," Conference Chair, Discussion Topics "Cost Sharing Buy-In Valuations" and "Volume Effects of Intangibles," Internal Revenue Service, Washington, DC, December 9-10, 2002.

"Economists in Transfer Pricing: Cost Sharing and Real Options," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, New York, NY, September 23, 2002.

"Valuation of Intangible Property and Cost Sharing Arrangements," Economist Group of the Internal Revenue Service, San Francisco, CA, June 25, 2002.

"Valuation of Intangible Property and Cost Sharing Arrangements," Southeast Region of Internal Revenue Service, Atlanta, GA, May 10, 2002.

"Economists in Transfer Pricing: CPM and Cost Sharing," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, Washington, DC, May 6-7, 2002.

"Pricing Cost Sharing Buy-Ins and Other Intercompany Transfers," Council for International Tax Education: U.S. Transfer Pricing Planning & Compliance, New York, NY, November 15-16, 2001.

"Pricing Cost Sharing Buy-Ins and Other Intercompany Transfers," ATLAS Intermediate U.S. International Tax Update, Cleveland, Ohio, November 5, 2001.

"Cost Sharing Buy-Ins: Market Capitalization, Declining Royalty, and Other Methods," Internal Revenue Service Annual Economist Convention, Washington, DC, July 25, 2001.

"The Relative Values of Early and Late Stage Research & Development," presentation to Shaw Pittman, McLean, Virginia, March 28, 2001.

"Valuation Concepts in Family Limited Partnerships," two hour presentation to Internal Revenue Service Northeast Engineers, Fort Monmouth, New Jersey, August 30, 2000.

"The Discounted Cash Flow Method and Other Valuation Concepts," two hour presentation to IRS Kansas and Missouri District Estate & Gift Tax attorneys and managers, Kansas City, Kansas, October 4, 1999.

"The Discounted Cash Flow Method and Other Valuation Concepts," presentation to IRS New York District Estate & Gift Tax attorneys and managers, New York, NY, August 16, 1999.

"Business Valuation," national closed circuit televised broadcast for Internal Revenue Service Estate Tax Agents, September 23, 1997 (with J. Murphy).

"Valuation and Finance Principles Applied to Transfer Pricing," a presentation to IRS and Treasury Department economists, Washington, DC, September 11, 1997 (with T. Reichert).

"The Peculiar Market for Commercial Property: An Economically Irrational Situation," Southwestern Economics Association Annual Meeting, Houston, Texas, March 23, 1996.

"The Robin Hood Bias: A Study of Biased Damage Awards," Southwestern Economics Association Annual Meeting, Houston, Texas, March 22, 1996.

"Quantifying Comparability for Applications in International Trade and Intercompany Transfer Pricing: The Weighted Distance Method of Analyzing Comparability," Southwestern Economics Association Annual Meeting, Houston, Texas, March 21, 1996.

"Some Economic Issues in Transfer Pricing," World Trade Institute: Tax Aspects of Intercompany Transfer Pricing, New York, NY, November 9-10, 1995.

MEDIA AND AWARDS

Inclusion in Euromoney's "Expert Guide to the World's Leading Transfer Pricing Advisors," 2010.

Bloomberg Television Interview, New York Stock Exchange Trading Specialists, October 8, 2003.

"Valuation Evaluation: How to Determine the Size of Interest in an LLC," CFO.com, Ask the Experts, August 31, 2001.

CONSULTING EXPERIENCE

CRITERION FINANCE, L.L.C., Washington, DC, 2001 - 2001
Partner and Senior Vice President

- Authored expert reports and articles on various transfer pricing topics, including cost sharing buy-ins.

- Wrote an expert report and provided deposition testimony estimating damages to a music database corporation from the anti-competitive acts of a competitor.

LECG, LLC, Washington, DC, 1999 - 2001
<u>Senior Managing Economist</u>

- Served as an economic expert in a pharmaceutical patent dispute regarding the relative values of early and late stage compounds.
- Submitted expert report on the process used to determine financial viability for state certified transportation services.

ECONOMIC CONSULTING SERVICES INC., Washington, DC, 1995 - 1999
<u>Senior Economist</u> (promoted from Economist)

- Analyzed transfer prices for corporations in a number of industries, including oil products, pharmaceuticals, consumer products, and software.
- Testified as an economic expert in international trade matters before the Canadian International Trade Tribunal and the U.S. International Trade Commission.

ARTHUR ANDERSEN, L.L.P., Washington, DC, 1994 - 1995
<u>Manager</u>, Economics Group

- Directed more than 20 transfer pricing studies.
- Submitted an expert witness report on executive compensation in Tax Court.

DELOITTE & TOUCHE NATIONAL TAX OFFICE, Washington, DC, 1992 - 1994
<u>Senior Consultant</u>, Economics Group

- Performed numerous tax economic analyses, primarily transfer pricing.
- Participated in seminars regarding transfer pricing and international taxation.

PROFESSORIAL EXPERIENCE

THE JOHNS HOPKINS UNIVERSITY, Washington, DC, 1997 - 2002
<u>Visiting Professor of Finance</u>

- MBA level Corporate Finance and Derivative Security courses.

MARYMOUNT UNIVERSITY, School of Business, Arlington, VA, 1993 - 1995
Visiting Professor of Statistics

- MBA and undergraduate level Statistics courses.

THE GEORGE WASHINGTON UNIVERSITY, School of Business and Policy Management, Washington, DC, 1992 -1993
Visiting Professor of Management Science

- MBA level Productions and Operations Management course.

UNIVERSITY OF PENNSYLVANIA, The Wharton School, Decision Sciences Department, Philadelphia, PA, 1988 - 1990
Instructor

- Undergraduate level Computer Applications courses.

March 2011

APPENDIX B

Appendix B: List of Documents Relied Upon

1. Archibald, W.C. (21 March 1996). "Letter to Mr. Alain Vachon Regarding Accounts Receivable Purchase." TD Factors Limited.

2. Australian Taxation Office. (April 2005). "International Transfer Pricing." Retrieved 26 February 2009 from http://www.ato.gov.au/content/downloads/LBI_35285_Applying_arms_length_principle.pdf.

3. Bodie Zvi, Kane, Alex, and Marcus, Alan J. (2002). Investments. McGraw-Hill Higher Education: Boston.

4. Bothwell, Robert. (November/December 2007). "Trade Receivables Risk: An Insider Perspective." Global Association of Risk Professionals. Iss. 39.

5. Broomhall, David. (21 March 2007). "Updating Comparables in Advance Pricing Agreements." Tax Management Transfer Pricing Report. Vol. 15, No. 22.

6. Canada Revenue Agency. (10 January 2008). Taxpayer Response to Audit Query No. T119-11.

7. CGSF Funding Corporation, McKesson HBOC, Inc., et. al. (25 June 1999). "Receivables Purchase Agreement."

8. Feinschreiber, Robert. (2004). Transfer Pricing Methods. John Wiley & Sons, Inc: New Jersey.

9. Hooper, Barbara A. (16 December 2002). "Letter Regarding McKesson Canada Corporation Receivable Sale." TD Securities Inc.

10. Li, Jinyan. (2002). "Global Profit Split: An Evolutionary Approach to International Income Allocation." Canadian Tax Journal. Vol. 50, Iss. 3.

11. Litterman, Robert and Iben, Thomas. (1991). "Corporate Bond Valuation and The Term Structure of Credit Spreads," Journal of Portfolio Management. Spring 1991, Vol. 17, No. 3.

12. Mankiw, N. Gregory. (2007). Principles of Economics. South-Western.

13. McCrodan, Andrew F. and Thériault, Charles. (14 December 2005). “Factoring Review.” PricewaterhouseCoopers.

14. McKesson Canada Corporation and McKesson International Holdings III S.ar.l. (3 December 2003). “Procedure Manual Accounts Receivable Purchase Program,” Annex D.

15. McKesson Canada Corporation. (13 December 2002). Consolidated Balance Sheet As at 13 December 2002. Alternatively know as Document R-67.

16. McKesson Canada Corporation. (15 February 2007). “Respondent's Document No. 1,000,079.” Alternatively known as Document R-45.

17. McKesson Canada Corporation. (15 June 2010). “Responses to Respondent's Follow-Up Questions.”

18. McKesson Canada Corporation. (18 December 2002). “Statement of Income, Market Segment - All.” Alternatively known as Document R-60.

19. McKesson Canada Corporation. (2003). “Amended Balance Sheet As of 29 March 2003.” Alternatively known as Document R-70.

20. McKesson Canada Corporation. (2003). “Amended Statement of Earnings As of 29 March 2003.” Alternatively known as Document R-70.

21. McKesson Canada Corporation. (2003). “Reconciliation to T106: FY03.” Alternatively known as Document December 15, 2009, Tab 34.

22. McKesson Canada Corporation. (2003). “Statement of Earnings (Unaudited) As of 29 March 2003.”

23. McKesson Canada Corporation. (4 December 2009). Detailed Departmental Expense Analysis for the Fiscal Year Ended 2000.

24. McKesson Canada Corporation. (4 December 2009). Detailed Departmental Expense Analysis for the Fiscal Year Ended 2001.

25. McKesson Canada Corporation. (4 December 2009). Detailed Departmental Expense Analysis for the Fiscal Year Ended 2002.

26. McKesson Canada Corporation. (Undated). "Appellant's Response to Request to Admit Facts, Folder 69."

27. McKesson Canada Corporation. (Undated). Document A-115.

28. McKesson Canada Corporation. (Undated). Document February 8, 2010, Tab 57.

29. McKesson Corporation. (10 June 2004). Form 10-K for the Fiscal Year Ended 31 March 2004.

30. McKesson Corporation. (12 June 2002). Form 10-K for the Fiscal Year Ended 31 March 2002.

31. McKesson Corporation. (6 June 2003). Form 10-K for the Fiscal Year Ended 31 March 2003.

32. McKesson International Holdings III S.a.r.l. "Financial Statements for the Period from September 25, 2002 (Date of Incorporation) to March 31, 2003." Alternatively known as Document R-130.

33. McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Servicing Agreement."

34. McKesson International Holdings III S.ar.l and McKesson Canada Corporation. (16 December 2002). "Receivables Sale Agreement."

35. McKesson Pharmaceutical. (11 March 2009). Actual Statement of Income for the Fiscal Year Ended 2000.

36. McKesson Pharmaceutical. (11 March 2009). Actual Statement of Income for the Fiscal Year Ended 2001.

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38. Medis Health & Pharmaceutical Services Accounts Receivable Statistics Period 13, 2000-2003.

39. Medis Health and Pharmaceutical Services Inc. (10 April 2001). "Statement of Income, Market Segment - All." Alternatively known as Document R-58.

40. Medis Health and Pharmaceutical Services Inc. (22 August 2002). "Statement of Income, Market Segment - All." Alternatively known as Document R-59.

41. Medis Health and Pharmaceutical Services Inc. (25 April 2002). Balance Sheet. Alternatively known as Document R-59.

42. Medis Health and Pharmaceutical Services Inc. (26 June 2001). Balance Sheet. Alternatively known as Document R-58.

43. Organisation for Economic Co-operation and Development. (August 1997). Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators.

44. Organisation for Economic Co-operation and Development. (July 1995). Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators.

45. Pratt, Shannon P., Reilly, Robert F., and Schweihs, Robert P. (1996). Valuing a Business: The Analysis and Appraisal of Closely Held Companies. 3rd Edition. Irwin Professional Book Group: Chicago.

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47. Retrieved 9 September 2009 from http://www.mckesson.ca/.

48. Retrieved 9 September 2009 from http://mckesson.ca/en/mckesson.ca/history.aspx.

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50. Retrieved 9 September 2009 from http://www.hoovers.com/mckesson-canada/--ID__121777--/free-co-factsheet.xhtml.

51. Retrieved 9 September 2009 from http://www.mckesson.com/en_us/McKesson.com/About%2BUs/Our%2BCompany/Our%2BHistory.html.

52. Rosenblum, Jeffrey I. (16 October 2002). "Estimating an Arm's-Length Interest Rate on Intercompany Loans." Tax Management: Transfer Pricing. Vol. 11, No. 12.

53. TD Factors Limited and The Toronto-Dominion Bank and Medis Health and Pharmaceutical Services Inc. (1996). "Accounts Receivable Purchase Agreement."

54. Todd S. (29 March 1996). "Letter to Mr. Alain Vachon Regarding Accounts Receivable Purchase." TD Factors Limited.