



# ADVISER

## Helping Public Companies

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## Watch Out for Transfer Pricing Rules

Does your company do business with an international parent, subsidiary or other related company? Then pay close attention to transfer pricing. Failing to comply with regulations, including new transfer pricing rules on intercompany services, may put your company at risk of significant penalties.

### Why it matters

Suppose you manufacture a product using component parts purchased from a foreign subsidiary, and that the foreign country's tax rates are significantly lower than U.S. rates. By paying an inflated price for the parts, you could reduce your U.S. profits and shift taxable income to the country with the lowest rate. Conversely, if your subsidiary is in a country with higher tax rates, you could minimize your tax liability by paying a heavily discounted price for the component parts and shifting income to the United States.

To discourage this sort of manipulation, transfer-pricing rules impose stiff penalties (as high as 40% of any additional tax owed in the United States) on intercompany transactions that aren't at "arm's length." These rules —



which exist in most taxing jurisdictions — apply to transactions involving tangible property, such as parts; intangible property, such as patents; and other transactions, such as loans and leases. Services now fall fully under the penalty regulations, so U.S. parent companies that provide shared services to foreign subsidiaries must recognize them as transactions.

### Setting arm's-length prices

To avoid violating transfer-pricing rules, you must: 1) set prices that are comparable to those paid in arm's-length transactions between unrelated parties, and 2) document the methods you use to set those prices.

There are several acceptable methods for setting appropriate transfer prices, depending on the laws and regulations in the relevant jurisdictions. Some methods, such as the comparable uncontrolled price method, examine prices in transactions between unrelated companies involving identical or comparable property. Other methods consider whether a company's profitability is similar to that of comparable public companies or whether profits are allocated appropriately among supply chain members. A new services cost method allows some back office services to be priced at cost.

In the United States, you're required to select the "best" method, in light of your company's circumstances, that provides the most reliable result. **h**

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