What you need to know

Transfer Pricing

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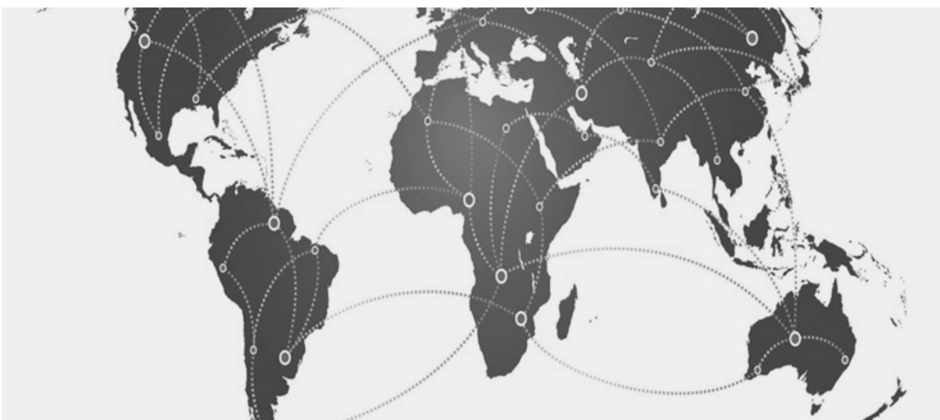
Some of the largest organizations, such as Amazon, Microsoft, and Hewlett-Packard have made national headlines due to disputes within the organizations' divisions regarding adjustments to income. However, even the smallest of companies can be greatly affected when it comes to transfer pricing. Transfer-pricing is often over-looked, but it affects organizations, of all sizes, throughout the entire world.



FAST FACTS

- Applies to all companies, both large and small, which transfer goods and services between subsidiaries or divisions (US & Global)

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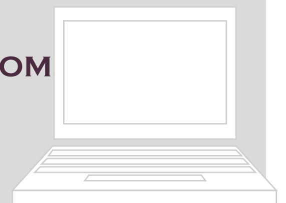

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Transfer Pricing

Transfer -pricing is the price that is paid between two related parties, when one provides a good or service to the other. For example, a transfer-price can occur between a domestic company and a foreign manufacturer. The price can vary since it is dependent on external and internal circumstances, such as market price and general cost.

At the Global Level

The most important transfer-pricing occurs at the global level. When items are manufactured, assembled or designed in a foreign country, transfer-pricing has a greater meaning. Recently, the IRS has placed transfer-pricing under the microscope pursuing cases which shed light to the unseen. For now, the IRS actively works to update and broaden guides to help companies correctly implement transfer-pricing.

How does it affect a company?

There are two major ways that transfer-pricing can affect the company.

First, transfer-pricing shifts profit between divisions. Some divisions within a company will report more or less revenue versus other divisions simply based on the determined transfer price. This affects the overall performance of the division.

The second way that transfer-pricing can affect a company is through taxation. Sales across the United States borders are reviewed by the IRS. Transfer pricing affects a company's tax liabilities in the U.S. as well as other countries and with various tax rates this can affect overall profit.

FYI

Be sure to talk with Reilly, Penner & Benton to learn the most current rules, regulations and changes that may apply to your organization when working with transfer-pricing throughout the world.

How is a price determined?

There are a few ways that a price can be determined. One way is through a market-based method. Through this method, the price is decided upon through watching the current market price of the good as well as the price of similar goods or services.

Another method is cost-based pricing, which determines prices by using the cost of production and possibly adding a markup cost in order to create a profit for the sellers.

Finally, negotiating prices is another way that can help determine a cost for goods and services. This way may be favored because each company division would find it mutually beneficial from negotiating a price.

How does the pricing work?

Transfer prices are important because they control costs and revenue for the divisions. Therefore, if the transfer price is too low, the division will not make a profit. This affects the performance evaluation of the upstream and downstream divisions in opposite, unbeneficial ways. For this reason, upstream divisions will try to sell their goods and services at market price, securing a profit. Outside orders can be more preferable especially when the market price is higher than the transfer price.

A Transfer Pricing Example

Marker International Inc. is a European subsidiary of U.S. based Markers Inc. The production cost for Markers Inc. is $.12. Markers International sells the markers to its European buyers at a price of $1.

A transfer price is charged by Markers Inc. (US) to Markers International Inc. (Europe). In theory this price could be between $.12 and $1.00, leaving one division to generate all of the company profit and the other to barely break even.

If there were no transfer price regulations, companies such as Markers Inc. would simply determine the country with the lowest tax rate and place all profit there. This would maximize their after-tax worldwide profit but leave one country unable to collect any tax revenue.

Contact our Tax team at

414.271.7800 with any questions