Transfer Pricing | Ask the Experts Video Transcript

Ellen Juram, Director, Multinational Tax Practice
Alex Martin, Principal, Transfer Pricing Economist, KBKG

December 2020

Ellen Juram (00:00):

Hi, and welcome to Barnes Dennig, Ask the Experts. I'm Ellen Juram, a tax director at Barnes Dennig, and my specialization is working with multinational companies, both foreign-owned, US-based companies and US headquartered companies that have operations outside of the US. Today we're going to be talking with Alex Martin about transfer pricing.

Ellen Juram (00:25):

Alex is a principal and transfer pricing leader at KBKG. He is a transfer pricing economist with 22 years of experience working in Washington, DC, Melbourne, Australia, and Detroit, Michigan over the course of his career. We have a lot to cover. So let's go ahead and get started.

Ellen Juram (00:42):

Alex, thank you for joining me today.

Alex Martin (00:44):

My pleasure. Thank you.

Ellen Juram (00:46):

Great. So over the past decade or two, we've seen a significant growth for many mid-size and small privately held companies being able to expand their operations outside the US. Historically, we always saw it was more of the large businesses that were able to operate outside the US, but now that we're just seeing more of those mid-sized companies doing that. Can you provide us a brief overview of what transfer pricing means, and what type of transactions they should be considered, especially if you're a smaller mid-sized company that maybe doesn't have a transfer pricing department?

Alex Martin (01:22):

Sure. Like you said, a lot of great small and medium sized companies are expanding internationally. Whether it be US companies expanding abroad or foreign companies investing in the US. Transfer pricing has to do with how much tax you pay by country. And let's just provide a high-level example.

Alex Martin (01:43):

Let's say, you got a US company expanding into Canada. Well, the price you charge on goods, services, royalties, or loans, on a cross border basis drives how much tax you pay by country. And that's important for a couple of reasons. One, let's say if you charge too high a price from the US to Canada, the Canadian tax authority is unhappy because they're not getting their fair share of tax. Conversely, if the company charges too low a price, the IRS is unhappy they're not getting their fair share of tax. So what a lot of companies are trying to struggle with, especially in the small medium enterprises, is to make sure they get that pricing correct because tax authorities on both sides of the border are interested in that.

Ellen Juram (02:36):

Great, thanks. So when looking at transfer pricing, how do you find out whether or not you have the correct price?

Alex Martin (02:48):

Well, the principle behind this is that you should be treating your sister companies, or parent subsidiary relationships, as if you were unrelated companies. So in other words, if you would charge a unrelated company a dollar for your widget, you should probably be charging your related company a dollar. Now, sounds great in theory, but a little more difficult to apply in practice.

Ellen Juram (03:18):

Okay great. So what about transfer pricing documentation? Is that something that these companies need to have, and how important is it?

Alex Martin (03:24):

Well, sure. Transfer pricing documentation, or transfer price analysis, are a way for companies to explain how their business operates, and why the prices they charge are arms length, or correct. And so a transfer pricing report is really the first and best opportunity to explain to a tax auditor, on either side of the border, how the company operates on a daily basis, which company does what function, and then why the pricing is correct or arms-length.

Ellen Juram (04:05):

Okay, good. Thank you. What are some of the benefits to doing transfer pricing, or making sure your transfer pricing is correct from a cashflow standpoint?

Alex Martin (04:15):

Sure. Well, transfer prices aren't always just affecting the taxes paid. It also impacts the cashflow. So quite often what you'll find is that if a company's just pulling a number out of the air, you may find that cash is accruing in one location where it's needed in somewhere else. Let's say to pay off debt, or make more investments. So transfer pricing is an important consideration to make sure you're paying the right amount of tax in multiple jurisdictions, and also making sure your cashflow is being effectively optimized to the extent possible.

Ellen Juram (04:58):

Okay. And so what are some of the transactions other than, there's obviously the purchase of materials, of product, going between the companies, but what other types of transactions would we be looking at under transfer pricing?

Alex Martin (05:12):

I find royalties are really a big deal just because so many companies operate over the internet, or they license their technology for manufacturing in different locations. All of this is important because again, maybe the tax authority in France, or Mexico, or China, what have you, the royalties, or explaining why intellectual property is being licensed, and what the payment structure is, really has a big impact for many of these companies.

Ellen Juram (05:58):

Right, and in some situations it can be as a way to get cash from one location to the other without it being deemed as a dividend.

Alex Martin (06:05):

Exactly.

Ellen Juram (06:07):

So that way they can get the deduction. Yeah, and then recently, I believe it was last month, there was a pretty significant case against the IRS with Coca-Cola. Could you tell us a little bit about that, and what that means to other taxpayers?

Alex Martin (06:21):

Sure. Coca-Cola recently lost a court case against the IRS. And the reason being is that the IRS was able to argue successfully that Coca-Cola was shifting profits from the US and leaving too much of the profit in their foreign subsidiaries that were supporting independent bottlers. But effectively the IRS said, well, companies in Ireland, Brazil, Mexico, number of locations, were earning so much profit that, that really didn't make sense from an economic point of view.

Alex Martin (07:08):

So effectively it turns into a $3 billion tax bill for Coca-Cola. Now, obviously most companies aren't as big as Coca-Cola, but it does illustrate that the IRS is interested in how much tax companies are paying both from them in the US and globally. And really it serves as a template for the IRS to walk in and say, hey are your subsidiaries earning too much profit? And if they are well, you better have a good explanation for that.

Ellen Juram (07:48):

Great. And kind of going back to that with audits, we've seen in the past that the IRS has had a directive, or initiative, with inbound companies, especially distributors not having enough profit. And also with some of the outbound companies, it's usually one of the first things that the IRS will ask for is that transfer pricing documentation, if there is any. What has been your experience on just making sure that you have that documentation ready ahead of time, versus when it's asked for under audit?

Alex Martin (08:23):

Sure. Generally speaking, if the IRS does have an audit, they walk in the door and ask, well please provide your transfer pricing documentation in 30 days. And it sure is a lot easier to address that a year or two before, then running around and trying to justify things over a 30 day period. Again, where we think there's a lot of value in planning these issues upfront, because it's much easier to identify and assess issues as they're happening or shortly after the year end, then trying to backfill what a reasonable argument is two or three years after the fact during an audit.

Ellen Juram (09:13):

Okay, great. Well, this was just to be really just a high-level overview of what transfer pricing is, and how this is important. You and I are going to be doing a transfer pricing webinar on December 10th, at 11 o'clock, where I think you're going to provide a lot more detail. Go into a little bit more of an in-depth overview on the importance of transfer pricing. So thank you for joining us today.

Alex Martin (09:39):

Thank you. And we look forward to being part of this.