

## TRANSFER PRICING AND SUBSIDIARIES

Transfer Pricing—these are two words you should be familiar with if your company is involved with inter-company transactions with foreign subsidiaries or foreign other related entities. Over the last few years, transfer pricing has become a topic subject to much more scrutiny by the IRS, as well as tax authorities worldwide. In this article, we look at the importance of having proper transfer pricing policies in place.



### A topic under scrutiny

The Internal Revenue Service has stepped up their approach and audit activities with regards to transfer pricing pursuant to Internal Revenue Code section 482. The regulations under this section provide a wide array of methods for pricing transactions between related parties for tangibles, intangibles and services. These regulations have also undergone changes in the past few years. One of the most important new regulations deals with how inter-company services can be charged to related entities.

### An example

Assume, for example, a U.S. company performs accounting services for one of their wholly-owned subsidiaries in Ireland. Under the old transfer pricing laws, the company was to charge the Irish subsidiary an arms-length price for these services. The IRS now believes time has been wasted examining these common types of back-office services and has changed the regulations to simplify the rules and to allow themselves more time for complex and substantial issues during transfer pricing examinations. Therefore in October of 2006 the new Simplified Cost-Based Method (SCBM) for services was released. This method basically allows a company to charge related entities for common back office services at cost rather than an estimate of fair market value. Of course, the IRS disallows this treatment for certain types of services that contribute to the competitive advantage of the company in addition to specific services mentioned in the new

regulations. However, for services that are eligible, it greatly reduces the uncertainty of pricing these services.

### Help is available

One can imagine the complexities of transfer pricing with regards to transactions between multiple foreign jurisdictions. Transfer pricing laws differ from country to country, which generally lead to compliance headaches for the company. It is now more important than ever to have proper transfer pricing policies and documentation in place, not only to satisfy the requirements of the United States, but those of all countries in which the company operates. These companies that fail to appropriately develop transfer pricing policies could face substantial penalties, as well as unexpected additional tax bills as a result of a transfer pricing examination.

To learn more about how Decosimo can assist your company with establishing the proper transfer policies, contact the Decosimo office nearest you.