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Transfer Pricing: A Reporting Requirement for Multinational Corporations

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It should come as no surprise that large companies often create affiliate and/or subsidiary companies to carry out various parts of their operations across the globe. These parent-affiliate/subsidiary corporations are considered related parties, and when they engage in transactions between one another, transfer pricing becomes a very important reporting requirement to consider.

The transfer price, by definition, is the price that one related party charges another related party in a particular transaction. For example, foreign Parent Company ("P") purchases widgets from U.S. Subsidiary Company ("S") at a standard price determined by P. The price that P pays to S for the widgets is the transfer price.

Intercompany transactions are common in the marketplace today. The purchase price of the widgets is not negotiated by the two related parties in the same way it would be between two unrelated parties. Thus, there exists a risk that the cost that P pays S for widgets will vary substantially from the cost of widgets had P purchased them from an unrelated company.

The IRS is concerned with ensuring that related parties are not using intercompany pricing as a mechanism to shift profits from one company located in a high tax rate jurisdiction to another related company in a lower rate jurisdiction. To accomplish this, the IRS has been granted the authority to require companies to report related-party transactions and show that transaction costs are within an acceptable range of comparable transactions in the market.

Let's look at our widget example above. The IRS requires P to report transactions between P and S, and show that comparable companies (same size, industry, etc.) would sell widgets to P for roughly the same cost. If the IRS finds that P is significantly underpaying or overpaying for widgets from S, it has the power to adjust transactions to better reflect the income of the related companies.

The Internal Revenue Code and Treasury Regulations have rigid requirements surrounding the annual reporting of transfer pricing. Regulations provide detailed instructions on how to choose comparable parties and how to calculate the appropriate, acceptable price ranges for comparison. Due to the nature of the analysis, every transfer pricing report is unique and must be tailored to the individual reporting party. There are consequences for failing to report or improperly reporting transfer pricing, so it's important for corporate taxpayers to keep reports current. Most countries have similar rules; recently implemented

Country by Country OECD reporting requirements have elevated the importance of contemporaneous documents.

If you have any concerns regarding related-party transactions or transfer pricing, it’s always best to consult your accountant or one of our tax professionals.

You’ve heard our thoughts… We’d like to hear yours