

# TRANSFER PRICING FOR MID-SIZED CORPORATIONS

---

Differences in  
Approaches to Planning,  
Documentation, and  
Controversy Management

**Michael Peggs**

Transfer Pricing Economist

[peggs@ruchelaw.com](mailto:peggs@ruchelaw.com)

**Stanley C. Ruchelman**

Attorney at Law

[ruchelman@ruchelaw.com](mailto:ruchelman@ruchelaw.com)

# Agenda

---

- Factors that make an S.M.E. unique
- Selecting and applying a transfer pricing method
- Implementing a transfer pricing result
- Documenting transaction pricing under Treas. Reg. §1.6662-6
- Managing I.R.S. transfer pricing controversy
- Q&A

# FACTORS THAT MAKE AN S.M.E. UNIQUE

---

# Why Are Mid-sized Companies Unique?

---

- Limited public information
- Information may be held by key people only
- Key people important to the viability of the business
- Business conditions can change very quickly
- Often no public debt, credit rating, bank debt, or debt issues
- Often no forecasts or budgets, business plan, job descriptions

# Why Are Mid-sized Companies Unique?

---

- Management of I.P., agreements, and guarantees
- Operations, issue or present-period focused management
- Often no tax function; someone is tasked with transfer pricing
- Large multinational issues at a fraction of the scale

# SELECTING AND APPLYING A TRANSFER PRICING METHOD

---

# Method Selection

---

- Best method rule (Treas. Reg. § 1.482-1(c)) is a multifactor evaluation process
- Factors are:
  - Comparability
    - Functions
    - Contractual terms
    - Risks
    - Economic conditions
    - Property or services
  - Data and assumptions
    - Completeness and accuracy of data
    - Reliability of assumptions
    - Sensitivity of results to deficiencies in data and assumptions
  - Confirmation of results by another method

# Method Selection

---

- An argument for a best method or methods
- Also an argument against other methods (Treas. Reg. §1.6662-6(d)(2)(ii)(A))

*A taxpayer can reasonably conclude that a specified method provided the most reliable measure of an arm's length result only if it has made a reasonable effort to evaluate the potential applicability of the other specified methods in a manner consistent with the principles of the best method rule*

- The best method rule is driven by data, not theory:

*Rather, after a reasonably thorough search for relevant data, the taxpayer should consider which method would provide the most reliable measure of an arm's length result given that data.*



# Method Selection

---

- Write down your argument against alternate methods (Treas. Reg. §1.6662-6(d)(2)(B)(5) principal document) to mitigate risk of penalty on adjustment
- Best method result should be corroborated with another method and different data
  - Large transactions
  - Risky transactions
  - Borderline results
- Find the right data by asking the right questions of the right people, and do some investigating
- Consider other possible sources of comparable transaction or company information

# Method Application

---

- Data most relevant to the transaction must be used: income statement segmentation is sometimes necessary
- Forecasts critical to buy-in payment, intangible asset sale or debt capacity calculations are often absent, insufficiently detailed, or contain unsupported assumptions
- How will the method and result be put into practice?
  - Transaction or invoice pricing
  - Transaction or S.K.U.-level accounting data
  - Pricing adjustments or updates
  - Post-importation payments and adjustments to value of imports and assists

# Method Selection

---

- Do confident, successful, experienced business people rely too heavily on experience to price transactions?
- Do advisors rely too heavily on profit-based methods and non-transactional approaches?
- Did the business attempt a comparable transaction, or conduct a successful comparable transaction?

# Method Selection

---

- Does a profit split contemplated when planning imply the profit split method is the best method?
- Inheriting a master file and method from a non-U.S. parent?
- Oversimplified L.R.D., service, and cost sharing models may not work for U.S. purposes.

# IMPLEMENTING A TRANSFER PRICING RESULT

---

# Accounting/Operations Implementation

---

- Accounting for individual transactions and corresponding intercompany accounts, inventory value
- Dealing with foreign exchange policy and mapping this to transaction risk
- Recording transactions to the right GL codes
- Intercompany invoicing and payment terms
- Pricing adjustments

# Accounting/Operations Implementation

---

- Reporting for Forms 5471 and 5472, measurement, and testing purposes
- Handling samples, returns, short-stock sales, budget overruns, capacity utilization, warranty claims, waste, rework, and expenditures on related party's behalf
- Calculations of services charges

# Legal Implementation

---

- Intercompany agreements
- Review of bank covenants
- Understanding of legal title and obligations of parties
- Communications and authority to take business risk and commit funds, and provide instructions



# Legal Implementation

---

- Record keeping
- Roles of executives and employees, and implications for employment contracts and payroll
- Agency implications for permanent establishment or state nexus
- Importer reporting and value for duty

# DOCUMENTING TRANSACTION PRICING UNDER §1.6662-6

---

# Why Document?

---

- Protection from Treas. Reg. §§1.6662-6(b) and (c) penalties
- An exam position on facts, method selection and pricing
- Concludes a year-end check of pricing or profit before financial statements and/or Form 1120 is prepared
- An opportunity to make sure domestic-foreign coordination is in place

# Why Document?

---

- An opportunity to address other international tax issues, catch customs issues
- An opportunity to discuss the transfer pricing position over the medium term and plan ahead
- Orderly return preparation
- Do not hide an issue; rather identify and address the issue with facts and plans known to operating management

# Information Gathering

---

- Privacy of “home office” or parent level information, especially profitability and salaries
- Talk to business people as well as finance people
- Be polite, but interview like an I.R.S. agent
- Think about sources of comparable transactions, arrangements or profit, and ask about these every year

# Information Gathering

---

- Borrow documentation from foreign jurisdictions and adapt to save time and effort, then check and confirm
- Focus on all transacting parties, not just the U.S. entity
- Don't assume that a transfer pricing report prepared for a foreign captive supplier yields an arm's length price

# Documentation Presentation

---

- Avoid over-reliance on profit-based methods and non-transactional approaches
- Inheriting a master file from a parent requires translation of O.E.C.D. English to American English and Code §482
- Include intercompany agreements and pictures, drawings, news items
- How much do general industry overviews contribute to situating the transaction and explaining economic conditions and risk? – Relate this back to the transaction and the position

# Documentation Presentation

---

- Documentation done only once in a while is expensive and fails to meet record maintenance standard
- A transfer pricing report may be required annually under foreign tax law prior to the time a tax return is filed
- Must coordinate approach between countries to the greatest extent possible
- Do not hide an issue – instead, identify, address, and resolve the issue with assistance from operating management



# MANAGING I.R.S. TRANSFER PRICING CONTROVERSY

---

# I.R.S. Audit Issues

---

- Inbound Distributor Campaign from LB&I – March 2017
- Training ground for new examiners
- Mid-sized companies viewed as non-compliant
- Companies benefit from the presence of long tenured management
- People and their business activities matter, so interview prep is important

# Managing a Transfer Pricing Audit

---

- Put a team together (accountant, attorney, economist)
- Set roles, establish point of contact and a plan
- Manage communication with the exam team
- Keep the client up to date through uncertain periods
- Gauge involvement of client in meetings with the I.R.S.
- Make use of long tenured management
- People and their business activities matter, so interview preparation is important
- First-person information about the business and transaction conditions is viewed as relatively credible

# Double Tax Case Resolution

---

- Cases often too small for A.P.A. program
- Not a priority for Competent Authority
- Cost of recovering double tax is high, so narrow down the issues and adjustments first
- Carefully consider taking the case to Appeals before Competent Authority

# Q&A

---

ruchelman

corporate  
international  
taxation

**NEW YORK**

---

Ruchelman P.L.L.C.  
Architects and Designers Building  
150 East 58th Street, 22nd Floor  
New York, New York 10155  
Tel. 212-755-3333

**TORONTO**

---

Ruchelman P.L.L.C.  
The Exchange Tower, P.O. Box 233  
130 King Street West, Suite 2300  
Toronto, Ontario M5X 1C8  
Tel. 416-350-2026

# Important Notice

This presentation is not intended to be legal advice. Reading these materials does not create an attorney-client relationship. The outcome of each case stands on its own merits.