Transfer pricing analysis — Minimize the risk of breaking the terms of the tax authorities and enhance company strategy

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Abstract

An international company structure may contain two or more entities, one of which is in one jurisdiction while the other is in another jurisdiction owned by the same owner. It is very necessary to conduct a transfer pricing analysis when two or more businesses do business with each other. Forgetting to do a transfer pricing analysis before moving products and services between businesses under common ownership may put you at danger with tax authorities.

Keywords: *Transfer Pricing, IRS*

Introduction

We may argue that our Amazon business, which is a U.S. corporation with a Hong Kong subsidiary, has a foreign parent in Hong Kong. Products are bought at a cheap price in China by the Hong Kong business. Once the purchased items have arrived in the U.S., the transaction then sends them to the U.S. business that sells them on Amazon at U.S. market pricing.

If you are considering transferring the products at a premium price to realise the majority of the profit in Hong Kong, you may be tempted to do so. Despite this, the merchandise is not to be sold at an inflated price in order to ensure that the profit remains in low-tax Hong Kong rather than in higher-taxed U.S. To ensure the transfer price of goods sent between Hong Kong and the U.S. are based on fair market value, as if sold between separate businesses, the transfer price should be reflective of the market value of the goods, not a discount from the value of the goods [3].

They must interact with each other on an arm's-length basis, like two corporations owned by different people [2].

It is critical to have a transfer pricing analysis completed during a tax audit.

The IRS and other international tax authorities carefully scrutinise transactions between businesses in various countries when such transactions involve related corporations. Extra scrutiny is always applied to the pricing of everything that transfers between businesses, including services, intangible assets like IP, and financial transactions. In order to make the proper allocation of the revenue, you must assign a proper part of the income to the right entity and pay tax on that amount. The findings of a transfer pricing research may be relevant in a tax audit.

A transfer pricing research sets inter-company pricing guidelines between the nations where transferred products are sold and their market value. As a basis for calculating transfer prices, this research provides. The nature of the book makes it a visible display of an individual's purpose to the tax authorities.

You do not have to provide the transfer pricing study with the tax return to the IRS in the U.S. As the IRS mandates, you have to provide your own W-2, and you must be prepared to show it to the IRS if they want it. You cannot show that you acted with reasonable cause or in good faith unless you have transfer price evidence. In order to reduce these penalties, the IRS has the authority to subject you to up to 40% of any tax understatement arising from an IRS investigation.

Tax treaties and transfer pricing

This is another situation where the problem is frequently more involved than the one described above, for example, if the business owner works from a second tax country. The owners of the businesses pay tax in the nation where they reside, even if the countries have tax treaties.

Assume, for the sake of argument, that the owner of the Hong Kong and U.S. businesses lives in Australia. He manages all of the business decisions from his office in Australia, where he also has an employee on staff full-time. Despite having a U.S. business, he pays taxes in Australia. His permanent establishment is in Australia because of this fact pattern and the U.S. Australia tax treaty; therefore, he will pay tax in that country. And, to meet the legal and regulatory requirements, he must comply with all Australian tax laws and follow Australian tax recommendations in his transfer pricing research [1].

Properly conducted transfer pricing research

The most important consideration in doing a transfer pricing research is finding market prices. Also, a transfer pricing study must be more than just a simple legal opinion. It is a rigorous and deep-dive business assessment of your company, goods, services, and intangible assets. Specific criteria exist in the U.S. for determining the “arm's length” character of pricing when two related businesses are involved.

For example, it must be done properly and with enough assistance utilising comparable royalty rates from royaltysource.com or via the use of publicly accessible data for looking for competitive transactions and margins.

Use of a third party is not required under U.S. regulations. However, in order to complete the study, researchers must adhere to a certain methodology and assessment approach. Additionally, more experienced professionals may spot dangers that business insiders fail to see.

Conclusion

When you do a transfer pricing analysis, you're also taking a proactive step to shield yourself against an audit. It's also an essential planning tool when dealing with cross-border operations.

To provide another example, by moving some operations from one jurisdiction to another, you may be able to realise substantial tax savings. When the remuneration for intangible assets and managerial operations is at arm's length, the usage of these intangibles is required. Even while it may lead to a more tax-efficient distribution of earnings within an international framework, it might instead lead to a more mobile global capital base.

Structuring experts that thoroughly grasp the tax consequences should be sought out if there are transactions that are linked between companies.

References

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