# 5 Quick questions about intercompany transactions & transfer pricing

Whether your organization is establishing new entities across state borders or overseas, or is already a multinational firm, transfer pricing should be on your to-do list. Transfer pricing deals with the pricing of related party transactions – an area that tax authorities are increasingly scrutinizing. If you're not fully confident that you're arranging transfer pricing fairly and consistently, here are a few frequently asked questions to help you better understand how it may apply to your business.

## Q: What is transfer pricing?

Transfer pricing refers to the price of transactions for goods, services, intangibles or financing between related parties. Transfer pricing comes into play with "cross-border" transactions, both international and domestic (across states). Transfer pricing establishes prices between the related parties so they are comparable to transactions between two independent, unrelated parties — this is known as "arm's-length" pricing.

## Q: Which companies need a transfer pricing study?

Organizations that have related party transactions involving multiple tax jurisdictions typically need a transfer pricing study, also known as a transfer pricing analysis. In addition to helping public and private companies across industries to actively address regulatory compliance and strategic business considerations related to cross-border transactions with related parties, this study can be especially valuable for businesses in industries such as:

- *Banks and financial services firms*
- *Real estate and private equity companies and funds*
- *Manufacturers and distributors*
- *Technology companies*
- *Professional and other business service firms*

## Q: How is transfer pricing established?

A transfer pricing study, establishes arms-length pricing for related party transactions by benchmarking against similar companies using both financial and non-financial information. The study identifies and describes your company's activities and risks that reasonably support the selection and application of a transfer pricing method, consistent with the requirements of U.S. regulations.

The study should be prepared by the time the tax returns are filed for the year and applied consistently across transactions between related parties. The study should also be updated periodically to capture changes specific to your company, industry or market.

## Q: How can a transfer pricing study benefit a business?

A transfer pricing analysis can help your company comply with federal tax requirements, manage profitability and increase efficiency. It can be used in many ways:

- *Comply with international as well as U.S. federal, state and local tax rules that require arm's-length pricing of transfers between related parties*
- *Benchmark your company's pricing against similar businesses around the globe*
- *Effectively allocate profits and losses by restructuring or shifting functions and risks*
- *Choose interest rate or royalties for intangible property transfer between organizational units*
- *Maximize tax efficiencies across jurisdictions and provide tax benefits for the parent company*
- *Establish reasonable cause and good faith for your pricing of transactions and substantiate tax positions through proper documentation in the event of scrutiny from the IRS or other tax authorities*

## Q: Does the IRS require businesses to file a transfer pricing analysis?

Your company's transfer pricing analysis is used internally and is not filed with the IRS, though these reports may be required to be filed with authorities in foreign jurisdictions. However, tax authorities are increasingly likely to scrutinize transfer pricing – it's one of the top areas the IRS looks at when it audits a company with international ties – and having a transfer pricing study can help you defend your position.

Tax authorities aim to prevent companies from underpaying tax by shifting profits to lower-tax jurisdictions through improperly priced related-party transactions. A properly conducted and applied transfer pricing study helps a business to establish reasonable cause and good faith. While it does not remove the risk of an audit, it does provide support for the way you priced related-party transactions, and it can reduce the risk of penalties. Transfer pricing penalties can be costly – potentially increasing your tax liability by up to 40%.

Contact Kaufman Rossin's tax advisors to help your organization avoid costly surprises and maximize tax efficiencies with a transfer pricing study.