



COMPANY IMPLEMENTS TRANSFER PRICING POLICY DURING COVID-19 & SAVES ON FOREIGN TAXES



Challenge

A multinational consumer goods company with several foreign entities did not have a proper transfer pricing policy in place.



Solution

Armanino had several conversations to establish a transfer pricing policy to match the value chain and risk profile of each entity of the company.



Result

By working with our transfer pricing team, the company was able to save a significant amount in taxes paid in a high-tax foreign jurisdiction.

CLIENT CHALLENGE

A multinational consumer goods company with several foreign entities did not have a proper transfer pricing policy in place since foreign sales compared to U.S. sales historically were not as material. However, the company had intercompany transactions with related parties operating in high-risk, high-tax jurisdictions.

The current pandemic impacted the businesses in unforeseen ways. The U.S. headquartered company was incurring losses, additional COVID-19 expenses, and additional manufacturing expenses due to the shutdown of its facilities. Meanwhile, the foreign entities have historically been profitable, earning high operating margins, which resulted in higher foreign taxes for the company.

THE TAX ISSUE

Without a proper transfer pricing policy in place, the company faced huge audit risk and higher foreign taxes. Additionally, the current pandemic situation added more strain to the liquidity of the parent company. Post-pandemic, tax authorities may focus on scrutinizing the transfer pricing policies and outcomes of taxpayers to differentiate between the COVID-19 impact versus any non-COVID-19 related factors. Therefore, the company needed to think about aligning the transfer pricing policy with the value chain of the company and also factoring in the appropriate impact of the pandemic.

OUR SOLUTION

Armanino had several conversations to establish a transfer pricing policy to match the value chain and risk profile of each entity of the company. There

were significant expenses in the U.S. as the headquarters company. The U.S. also oversaw the operations of the foreign entities, and the foreign entities had limited roles in performing the buy/sell function. All the strategic functions including the negotiation of sales contracts and marketing decisions were undertaken by the parent company. Therefore, it was appropriate to recharacterize the foreign entity as a limited risk distributor. After revising the transfer pricing policy for one foreign subsidiary, the company was able to recognize significant tax savings and reduce the strain on liquidity by repatriating excess profits to the parent company.

	US Parent	Foreign Sub Operates as a distributor in high tax jurisdiction	Total
Prior to having a proper transfer pricing policy			
Revenue	\$90,000,000	\$10,000,000	\$100,000,000
COGS + Operating Expenses	\$75,000,000	\$5,250,000	\$80,250,000
Operating Income	\$15,000,000	\$4,750,000	\$19,750,000
Effective Tax Rate	21%	30%	
Original estimated taxes	\$3,150,000	\$1,425,000	\$4,575,000
		Limited risk distributor earning 4% operating margin	
Return on sales		\$400,000	\$400,000
Excess profits repatriated to US parent	\$4,350,000		\$4,350,000
Total taxable income	\$19,350,000	\$400,000	\$19,750,000
Revised estimated taxes	\$4,063,500	\$120,000	\$4,183,500
Net tax savings			\$391,500

THE RESULT

By working with our transfer pricing team, the company was able to save a significant amount in taxes (almost \$400K) paid in a high-tax foreign jurisdiction. In the current pandemic situation, having a proper transfer pricing policy in place helped the company utilize the losses in the parent company to offset income being moved from high-tax jurisdictions.



OUR EXPERT

Nghi Huynh
Tax Partner, Transfer Pricing
Nghi.Huynh@armaninoLLP.com
408 200 6429