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## HLB North American Conference November 30, 2017

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## Learning Objectives

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- Inbound transactions to North America
- Update on BEPS Action Item 13

## Transfer Pricing Overview



- Price at which tangible property, intangible property, services, and financing / leasing are transferred between related entities of an organization, across both international and state borders
- “Fair” share of operating profit between related entities based upon functions, risks, and assets
- Arm’s-length pricing

## Transfer Pricing Method Comparison

OECD Guidelines vs. §1.482 Regulations



	U.S. Tangibles	U.S. Services	U.S. Intangible	U.S. Cost Sharing	OECD Guidelines
Transaction Methods	CUP	CUSP	CUT	CUT	CUP
	CPLM	CSPM		APM	CPLM
	RPM	GSMM		MCM	RPM
Profit-based Methods	CPM	CPM	CPM	Income Method	TNMM
	PSM • Comparable • Residual	PSM • Comparable • Residual	PSM • Comparable • Residual	RPSM • Different from -6 RPSM	TPSM • Contributory • Residual

**Abbreviations:**

- CUP = Comparable Uncontrolled Price
- CUSP = Comparable Uncontrolled Services Price
- CUT = Comparable Uncontrolled Transaction
- CPLM = Cost Plus Method
- CSPM = Cost of Services Plus Method
- RPM = Resale Price Method
- GSMM = Gross Services Margin Method
- TNMM = Transactional Net Margin Method
- CPM = Comparable Profits Method
- TPSPM = Transactional Profit Split Method
- PSM = Profit Split Method
- APM = Acquisition Price Method
- MCM = Market Capitalization Method
- RPSM = Residual Profit Split Method

## Applied Reality

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- Numerous profit- and transaction-based methods exist
- Method most often applied: comparable profits method (CPM) / transactional net margin method (TNMM)
  - Compares functionally-similar companies' *interquartile range* of operating results to *tested party's*
  - Often most reliable data available (e.g., audited SEC filings) and applicable *profit level indicator*
  - Regulations require comparable operating vs. gross profit (i.e., attempt to capture total cost)
  - Often default method of tax authorities

## Interquartile Range

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Operating Margins

Comparable	2014	2013	2012	Weighted Average
AMERISOURCEBERGEN CORP	1.0%	1.1%	1.6%	1.2%
CARDINAL HEALTH INC	2.1%	1.9%	1.7%	1.9%
MCKESSON CORP	1.9%	1.9%	1.9%	1.9%
MWI VETERINARY SUPPLY	4.1%	4.3%	4.2%	4.2%
OWENS & MINOR INC	2.0%	2.2%	2.3%	2.2%
PATTERSON COMPANIES INC	8.6%	8.9%	9.7%	9.1%
SCHEIN (HENRY) INC	6.9%	7.1%	7.1%	7.0%
VWR FUNDING INC	7.1%	6.8%	6.1%	6.7%
Minimum	1.0%	1.1%	1.6%	1.2%
Lower Quartile	1.9%	1.9%	1.8%	1.9%
Median	3.1%	3.3%	3.2%	3.2%
Upper Quartile	7.0%	7.0%	6.6%	6.8%
Maximum	8.6%	8.9%	9.7%	9.1%
Observations	8	8	8	8

## IRS Targets Foreign-owned Distributors



- February 2017, IRS issued new campaign targeting U.S. distributors of foreign goods sourced from foreign-related parties
- Focus on loss-making and low-margin entities, reported on U.S. tax return

## Case Study #1



- Fidget UK produces and sells kids fidget spinners
- Historically only sold in UK
- High demand for fidget spinners in U.S.
- Fidget US entity was created to service those needs



## Fidget – CPM / TNMM

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- Client inquired about how to charge for all activities Fidget UK performs that benefit Fidget US
  - Unnecessarily complicated
  - IRS/HMRC concerned with taxable income
- Fidget US provides limited risk distribution for Fidget UK; bears little risk; and earns a routine OM (let's say 5%)
- Fidget UK manages, organizes, and oversees all operations in U.S.; bears most risk; and earns residual profit

## An Isolated Example

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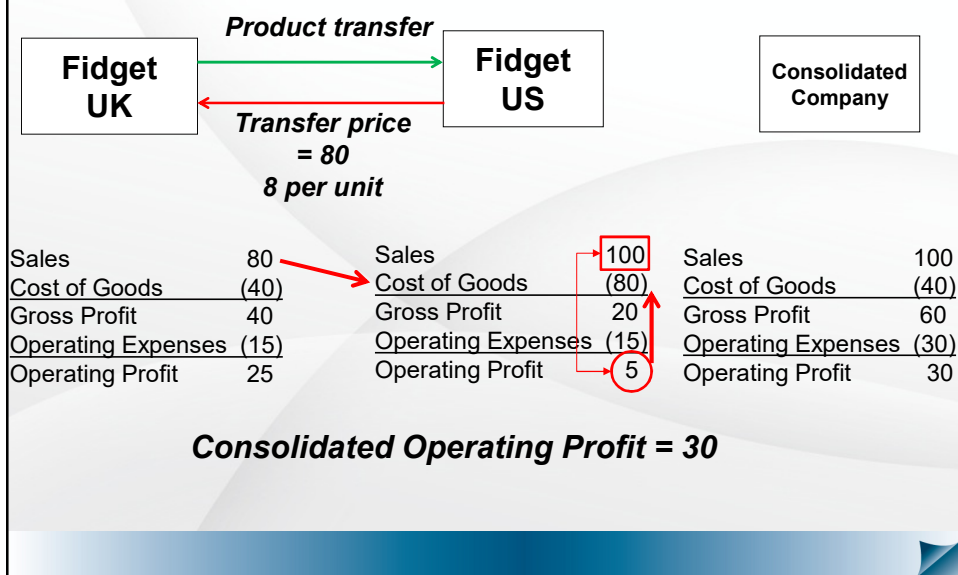
### Fidget US

Sales	100
Cost of Goods	(80)
Gross Profit	20
Operating Expenses	(15)
Operating Profit	5

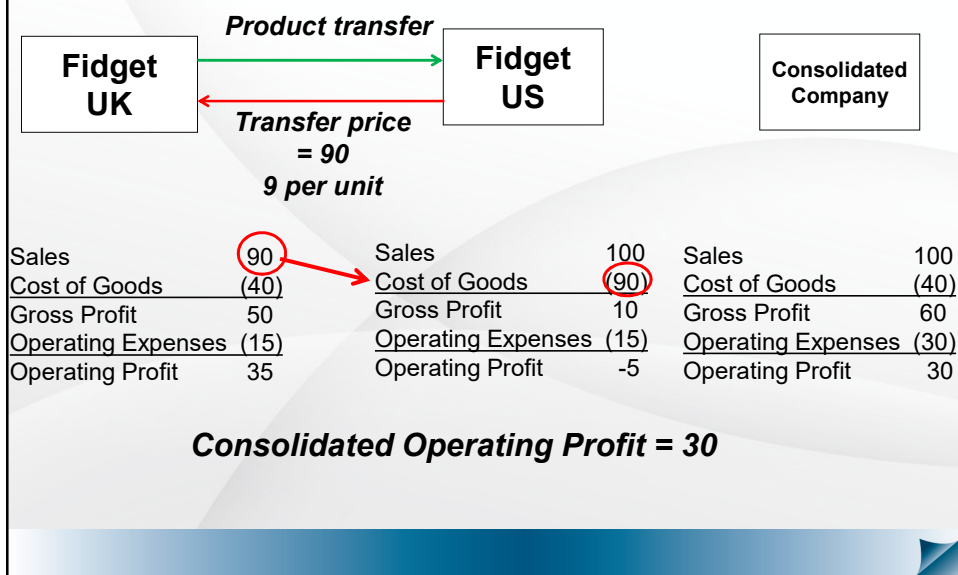
- This is the profit and loss statement of a Fidget US distribution company
- Does it have any transfer pricing issues?
- Does it have any transfer pricing risk exposure?

***In isolation, it is impossible to assess anything.***

## Telling the Transfer Pricing Story



## Effect of a Higher Transfer Price



## Case Study #2

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- Comparable uncontrolled price (“CUP”) method is sometimes a preferred method by tax authorities, but it is often misused and leads to risk (i.e., due to applied reality)
- Comparability of functions, contractual terms, risks, economic conditions, and products are key
- Example:
  - ABC Co. sells products to unrelated party as well as related party
  - ABC Co. uses sale price to unrelated party as sale price to related party

## ABC Co. – CUP Method

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- CUP method could be the best method, so long as the high degree of comparability is met
  - Similarity of products will generally have the greatest impact (e.g. type and quality)
  - But, minor differences in contractual terms (e.g. volume) or economic conditions (e.g. level of market or geographic market) could have a significant impact too
- Check entity-level profitability!

## BEPS Update

## Action Item 13 by Country

Countries	BEPS Action 13: Transfer Pricing Documentation
Argentina	Supporting - legislation enacted
Australia	Supporting - legislation enacted
Austria	Supporting - legislation enacted
Belgium	Supporting - legislation enacted
Brazil	Supporting - legislation enacted
Canada	Supporting - legislation enacted
Chile	Supporting - legislation enacted
China	Supporting - legislation enacted
Colombia	Supporting - legislation enacted
Cyprus	Supporting - legislation enacted
Czech Republic	Supporting - legislation enacted
Denmark	Supporting - legislation enacted
Egypt	Supporting - no legislation yet
Finland	Supporting - legislation enacted
France	Supporting - legislation enacted
Germany	Supporting - legislation enacted
Greece	Supporting - legislation enacted
Hong Kong	Supporting - legislation proposed
Iceland	Supporting - legislation enacted
India	Supporting - legislation enacted
Indonesia	Supporting - legislation enacted
Ireland	Supporting - legislation enacted
Israel	Supporting - legislation proposed
Italy	Supporting - legislation enacted
Japan	Supporting - legislation enacted

Countries	BEPS Action 13: Transfer Pricing Documentation
Korea (Rep.)	Supporting - legislation enacted
Liechtenstein	Supporting - legislation enacted
Luxembourg	Supporting - legislation enacted
Malaysia	Supporting - legislation enacted
Mexico	Supporting - legislation enacted
Netherlands	Supporting - legislation enacted
New Zealand	Supporting - legislation enacted
Norway	Supporting - legislation enacted
OECD	Supporting - legislation proposed
Poland	Supporting - legislation enacted
Portugal	Supporting - legislation enacted
Romania	Supporting - legislation enacted
Russia	Supporting - legislation proposed
Saudi Arabia	Supporting - no legislation yet
Singapore	Supporting - legislation enacted
South Africa	Supporting - legislation enacted
Spain	Supporting - legislation enacted
Sweden	Supporting - legislation enacted
Switzerland	Supporting - legislation enacted
Thailand	Supporting - no legislation yet
Turkey	Supporting - legislation proposed
United Kingdom	Supporting - legislation enacted
United States	Supporting - legislation enacted
Venezuela	No indication yet
Vietnam	Supporting - legislation enacted



## HLBI TP Group

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### BEPS - Transfer Pricing Action Items Latest Status by Country

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Discussion started by **Jason Fritts** 3 months ago



Dear All -

Attached is a spreadsheet describing the latest status of BEPS Transfer Pricing Action Items 8-10 and 13, formatted by country.

Warm regards,

#### Available Files

**BEPS\_Global\_Ct**  
Uploaded by Jason  
9 hits, 0.01MB

- [http://hlbi.com/index.php?option=com\\_community&view=groups&task=viewdiscussion&groupid=320&topicid=235&Itemid=1501](http://hlbi.com/index.php?option=com_community&view=groups&task=viewdiscussion&groupid=320&topicid=235&Itemid=1501)

## Questions

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- Thank you!