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Isaac M. O'Bannon • Jun. 06, 2023



In 2018, the U.S. Supreme Court ruled in *South Dakota v. Wayfair, Inc.* that states had much greater ability to enforce sales and use tax collections on out-of-state merchants. The initial response to this decision was fairly minimal, aside from some splashy news headlines. It seems few had really thought through the tsunami effect it could have.

A few years later, as states discovered and tested their own adaptations of taxation on

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Transfer pricing

A new version of the Wayfair decision may be underway, as stricter regulation of transfer pricing becomes more broadly implemented by tax agencies around the world, affecting even small businesses. Transfer pricing is the price of a transaction between related parties (e.g., a parent company and its subsidiary).

While the tax principles involved affect businesses large and small, it may be easiest to explain to those new to the concept by picturing a large corporation such as The Coca-Cola Co. Although the parent company is a U.S.-registered corporation, the beverage maker has subsidiaries, partnership agreements, licensing agreements, and other such arrangements in nations around the world, with bottling plants, workers, marketing, development, consultants, and other activities in various countries.

All the intercompany transactions between the various entities must be managed from a tax compliance perspective, which is done with a compliant transfer pricing study. In the United States, you must be able to show that your transfer pricing study was completed prior to filing your corporate income tax return to avoid penalties. In many other countries you must attest by checking a box on the tax return form that you have a compliant transfer pricing study in hand prior to filing your tax return.

This principle increasingly applies to small and midsized organizations who sell, source, research, develop, have affiliates, or have any market presence in more than their home nation. As such, even small ecommerce businesses and startups that have yet to realize any revenue may have transfer pricing reporting obligations in those nations.

“Transfer pricing helps ensure that a company does not artificially allocate income from one taxing jurisdiction to another just for the purpose of tax minimization,” said Sean King, the founder of Align Global Consulting. Align helps businesses create

organizational structures and improve operations and offers counsel addressing legal

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With ecommerce now driving sales, services, development, and distribution across most areas of the economy, even smaller and midsize organizations are engaging in activities that can result in their being deemed multinational and making them responsible for compliance with the transfer pricing regulations as implemented by the IRS and more than 135 other nations. Even early-stage startups that have not yet produced products or services may be subject to these rules.

According to Eran Shif, the Senior Director of Transfer Pricing at tax technology company Avalara, global international trade **involves more than \$30 trillion per year in transactions and sees about 2% annual growth**. And about 30% of these are intercompany transactions. He said these include large multinationals like Nike and Apple, but also small and midsize wholesalers, manufacturers, retailers, service providers, licensors, and consultants.

As nations have seen the volume and value of intercompany transactions climb, they have been more focused on accurately assessing their share of the global multinationals' total profit so that they can tax those transactions, hence the likelihood of transfer pricing audits has increased. In surveys among tax leaders, transfer pricing is typically identified as high tax risk for multinationals.

Enforcement

As noted previously, the key to proper valuation of intercompany transactions is the price that would have been determined if the transaction was between unrelated parties, under similar circumstances. Doing so ensures that each company within the multinational parent entity is properly taxed in its respective jurisdiction, instead of shifting profits to the nation with the lowest tax rate.

To accomplish this, the IRS and many taxing authorities have joined in partnership with The Organization for Economic Cooperation and Development (OECD) to unify

the principles, methods, and documentation relating to intercompany transactions.

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transaction involving the transfer of goods, services, or intangibles, yield results that are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances.”

In short, if the IRS thinks that an entity incorrectly reported their revenues, they can adjust it, as well as deductions, credits, and other factors. To avoid this potentially unfavorable result, the company must establish proper transfer pricing practices, based on accepted benchmarks and corroborating documentation, in order to defend and justify their position.

As an integral component of the broad consulting services that Align Global Consulting provides to multinational firms, it has offered transfer pricing guidance and reporting for more than a decade to organizations of all sizes, from emerging growth companies to the Fortune 100. The firm originally built and maintained databases of benchmark data, an extensive, time-consuming, and ever-ongoing process, as well as relying on externally sourced data and other software databases. Unfortunately, King says they found those systems to be “expensive and not at all user-friendly. Moreover, the system providers lacked critical support.”

The solution is automation

Following careful evaluation of available transfer pricing reporting automation tools, King and his consultancy implemented [Avalara Transfer Pricing Reports for Accountants](#), one of the tools available as part of the [Avalara for Accountants program](#). King says the system automates the transfer pricing documentation process, providing greater control and visibility while enabling financial consultants and accounting professionals, with or without in-house transfer pricing expertise, to prepare transfer pricing reports for their clients in three simple steps: data collection, documentation review, and report generation.

“The development of the product has been truly remarkable, evolving into a solution

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pricing discussion.

Moreover, our firm is a member of several global organizations and we have been fortunate to develop a reputation in this space.” Align Global Consulting also utilizes Avalara Transfer Pricing Reports for Accountants to provide transfer pricing services to accounting firms seeking to outsource this specialized area for their clients.

Standardization is a strength

King emphasizes that it is also important to remember that transfer pricing is a bilateral issue with two tax authorities involved. Therefore, if a company is overvaluing an agreement with regard to India, and undervaluing it with regard to the U.S., the IRS will want to adjust it in their favor. If the valuation is improper the other way, then India's tax authority would want to see it adjusted more toward their assessment. The key is to find a rate of compensation that satisfies both taxing countries.

King notes that this area is one of the biggest ticket items for tax authorities worldwide. “They see it as low hanging fruit, and think taxpayers aren't always properly assigning value or documenting their decisions. This makes it squishy, nuanced, and subjective, which makes it easy for authorities to disagree. That is why Forms 5471 and 5472 require a business to disclose the related party transactions when filing their U.S. tax returns, and to take a position on those transactions.” The IRS then shares this data with the other involved taxing authorities.

One of the key factors in the success of the Avalara transfer pricing solution is Avalara's industry reputation as a tax software authority. King says using this solution, he's able to provide his clients with reporting based on strong benchmark data that can be immediately provided to taxing authorities upon request. This

experience demonstrates that the client's company is prepared to defend its positions

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- [Link to our website on Transfer Pricing](#)
- [Why You Should Offer Transfer Pricing for Clients](#)

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