

THEME: CREATING VALUE IN A DYNAMIC BUSINESS ENVIRONMENT



ANNUAL MANAGEMENT CONFERENCE
PRESENTATION: Taxation and Transfer
Pricing In Cost Management

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Key areas in the presentation

**Management Control Systems.
Transfer Pricing, Taxation
Transfer pricing tax challenges
and
cross-boarder and Multinational
Considerations**

Responsibility Accounting

Describe a management control system and its three key properties.

Management Control Systems

A management control system is a means of collecting , analyzing and using information.

It guides the behavior of managers and employees in an organization.

Management Control Systems



Financial data

Nonfinancial data

Formal control system

Informal control system

Evaluating Management Control Systems

Motivation

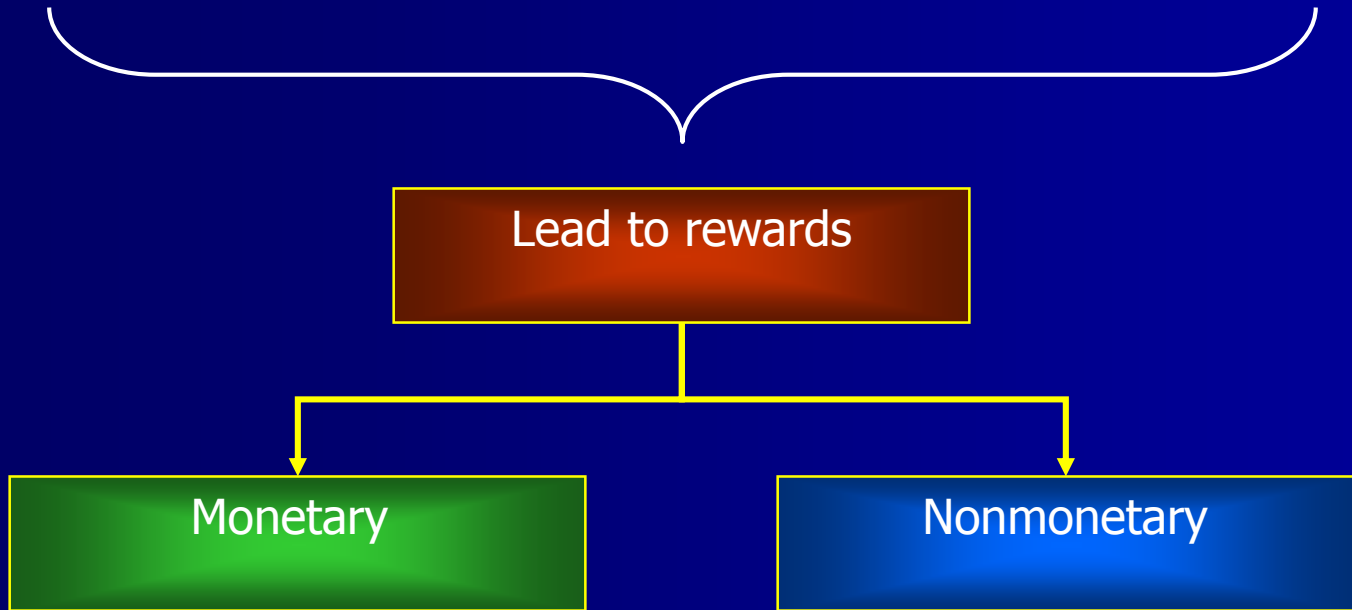
Goal congruence

Effort

Lead to rewards

Monetary

Nonmonetary



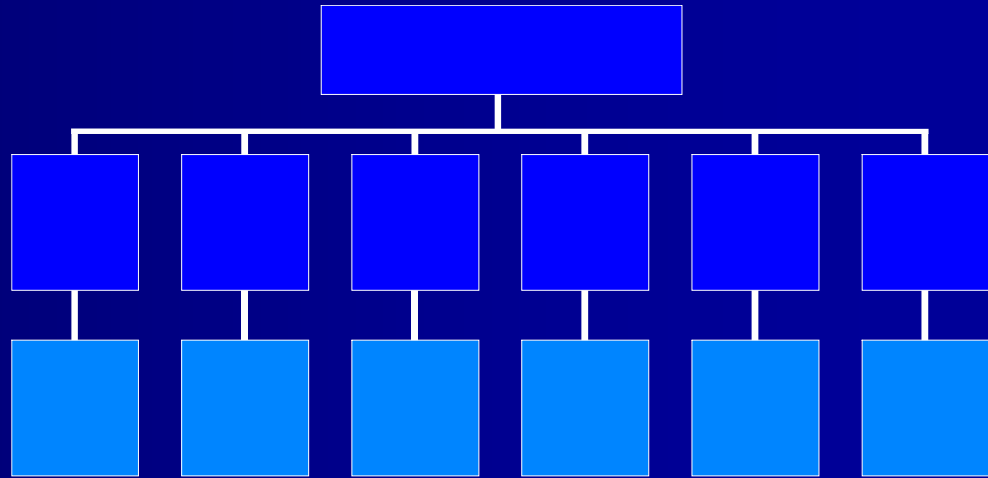
Responsibility Accounting

Describe the benefits and costs of decentralization.

Organization Structure

Total decentralization

Total centralization



Benefits of Decentralization

Creates greater responsiveness to local needs

Leads to gains from quicker decision making

Increases motivation of subunit managers

Assists management development and learning

Sharpens the focus of subunit managers

Responsibility Centers



The diagram consists of four colored ovals arranged in a 2x2 grid. The top-left oval is brown and contains the text 'Cost center'. The top-right oval is green and contains the text 'Revenue center'. The bottom-left oval is blue and contains the text 'Profit center'. The bottom-right oval is orange and contains the text 'Investment center'. Each oval has a slight 3D effect with a darker shadow on its left side.

Cost
center

Revenue
center

Profit
center

Investment
center

General Criteria

Explain transfer prices and four criteria used to evaluate them.

Transfer Pricing

A *transfer price* is the price one subunit charges for a product or service supplied to another subunit of the same organization.

Intermediate products are the products transferred between subunits of an organization.

Transfer Pricing

Transfer pricing should help achieve a company's strategies and goals.

- fit the organization's structure

- promote goal congruence

- promote a sustained high level of management effort

Examples

**Calculate transfer prices using
three different methods.**

Transfer-Pricing Methods



Market-based transfer prices

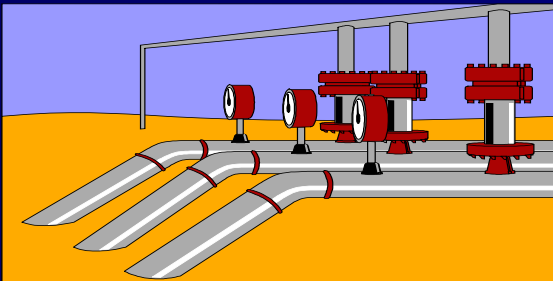
Cost-based transfer prices

Negotiated transfer prices

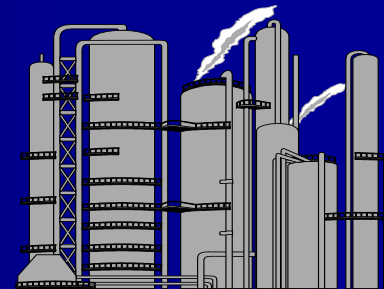
Transfer-Pricing Methods Example

Taxworld & Co. has two divisions:
Logistic and Refining.

Logistic purchases
crude oil in Nigeria and
sends it to Namibia .



Refining processes
crude oil
into gasoline.



Transfer-Pricing Methods Example

External market price for supplying
crude oil per barrel:

\$13

Logistic Division:

Variable cost per barrel of crude oil

\$ 2

Fixed cost per barrel of crude oil

3

Total

\$ 5

The pipeline can carry 35,000 barrels per day.

Transfer-Pricing Methods Example

External purchase price for crude oil per barrel:	\$23
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Refining Division:

Variable cost per barrel of gasoline	\$ 8	
Fixed cost per barrel of gasoline	<u>4</u>	
Total		\$12

The division is buying 20,000 barrels per day.

Transfer-Pricing Methods Example

The external market price to outside parties is \$60 per barrel.

The Refining Division is operating at 30,000 barrels capacity per day.

Transfer-Pricing Methods Example

What is the market-based transfer price
from Logistic to Refining?

\$23 per barrel

What is the cost-based transfer price
at 112% of full costs?

Transfer-Pricing Methods Example

Purchase price of crude oil	\$13
Variable costs per barrel of crude oil	2
Fixed costs per barrel of crude oil	<u>3</u>
Total	\$18

$$1.12 \times \$18 = \$20.16$$

What is the negotiated price?

Between \$20.16 and \$23.00 per barrel.

Transfer-Pricing Methods Example

Assume that the Refining Division buys 1,000 barrels of crude oil from the logistic Division.

The Refining Division converts these 1,000 barrels of crude oil into 500 gallons of gasoline and sells them.

What is the Logistic Division operating income using the market-based price?

Transfer-Pricing Methods Example

Logistic Division:

Revenues: ($\$23 \times 1,000$)	\$23,000
Deduct costs: ($\$18 \times 1,000$)	<u>18,000</u>
Operating income	\$ 5,000

What is the Refining Division's operating income using the market-based price?

Transfer-Pricing Methods Example

Refining Division:

Revenues: ($\$60 \times 500$)	\$30,000
Deduct costs:	
Transferred-in ($\$23 \times 1,000$)	23,000
Division variable ($\$8 \times 500$)	4,000
Division fixed ($\$4 \times 500$)	<u>2,000</u>
Operating income	\$ 1,000

Transfer-Pricing Methods Example

What is the operating income of both divisions together?

Logistic Division	\$5,000
Refining Division	<u>1,000</u>
Total	\$6,000

Transfer-Pricing Methods Example

What is the Logistic Division's operating income using the 112% of full cost price?

Logistic Division:	
Revenues: ($\$20.16 \times 1,000$)	\$20,160
Deduct costs: ($\$18.00 \times 1,000$)	<u>18,000</u>
Operating income	\$ 2,160

What is the Refining Division operating income using the full cost price?

Transfer-Pricing Methods Example

Refining Division:

Revenues ($\$60 \times 500$)	\$30,000
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Deduct costs:

Transferred-in ($\$20.16 \times 1,000$)	20,160
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Division variable ($\$8.00 \times 500$)	4,000
---	-------

Division fixed ($\$4.00 \times 500$)	<u>2,000</u>
--	--------------

Operating income	\$ 3,840
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Transfer-Pricing Methods Example

What is the operating income of both divisions together?

Transportation Division	\$2,160
Refining Division	<u>3,840</u>
Total	\$6,000

Market-Based Transfer Prices

By using market-based transfer prices in a perfectly competitive market, a company can achieve the following:

Goal congruence

Management effort

Subunit performance evaluation

Subunit autonomy

Cost-Based Transfer Prices Example

The Refining Division of Taxworld & Co. is purchasing crude oil locally for \$23 a barrel.

The Refining Division located an independent producer in Nigeria that is willing to sell 20,000 barrels of crude oil per day at \$17 per barrel delivered to the pipeline (Transportation Division).

Cost-Based Transfer Prices Example

The Logistic Division has excess capacity and can transport the crude oil at its variable costs of \$2 per barrel.

Should Taxworld purchase from the independent supplier?

Yes.

There is a reduction in total costs of \$80,000.

Cost-Based Transfer Prices Example

Alternative 1:
Buy 20,000 barrels from the
local supplier at \$23 per barrel.

The total cost to Taxworld is:
 $20,000 \times \$23 = \$460,000$

Cost-Based Transfer Prices Example

Alternative 2:

Buy 20,000 barrels from the independent supplier in Nigeria at \$17 per barrel and transport it to Namibia at \$2 per barrel.

The total cost is:

$$20,000 \times \$19 = \$380,000$$

Cost-Based Transfer Prices Example

Suppose the Transportation Division's transfer price to the Refining Division is 112% of full cost.

What is the cost to the Refining Division?

Cost-Based Transfer Prices Example

Purchase price of crude oil	\$17
Variable costs per barrel of crude oil	2
Fixed costs per barrel of crude oil	<u>3</u>
Total	\$22

$$1.12 \times \$22 = \$24.64$$

$$\$24.64 \times 20,000 = \$492,800$$

Capacity Underutilization

Understand the range over which two divisions negotiate the transfer price when there is unused capacity.

Tax Effect

**Incorporate income tax
considerations in
Cross boarder Transactions
transfer pricing.**

FAMOUS CASE ON TAX PLANNING

- ❑ All taxpayers are at liberty to arrange their affairs in manner that minimizes their tax liability through commercial activities.**
- ❑ Lord Clyde's words in *Ayrshire Pullman Motor Services & Ritchie v Inland Revenue Commissioners* ruled as follows:**

FAMOUS CASE ON TAX PLANNING

"No man ... is under the smallest obligation, moral or other, so to arrange his legal relations to his business or to his property as to enable the Revenue [authority] to put the largest possible shovel in to his stores. The Revenue [authority] is not slow – and quite rightly – to take every advantage which is open to it under the taxing statutes for depleting the taxpayer's pocket. And the taxpayer is, in like manner, entitled to be astute to prevent, so far as he honestly can, the depletion of his means by the Revenue [authority]."

❑ As part of Corporate Governance Code, the Board of directors must disclose in annual report its business risks (strategic, operational, financial and compliance risks).

❑ Taxes fall under the business risks of compliance and may involve either the below the line taxes or transactional taxes.

❑ Tax risks management entails the risks associated with non-compliance with tax legislation, risks of wrong reporting or risks of missed opportunity to save tax cash outflow.

❑ The big picture is that taxes can curtail corporate strategy and company reputation.

❑ **The following are identified as risks that are inherent in an organization tax system:-**

❑ **Valuation risks**-The risks that the tax amount disclosed in Financial Statements are wrong. This may include both corporate taxes, differed taxes and transaction taxes as VAT and other levies

❑ **Reputation risk**-The risk that failure to pay taxes may have a negative impact on a company after a revenue authority audit that may disclose additional taxes that are well above its cash flow ability.

❑ **Operation risk**-We have some taxes that are outside the scope of the tax department but may curtail business performance. E.g payroll taxes, VAT and information reporting

❑ The above can only be managed by a change in human factor and changes of cultural aspects (correct **“Tone at the top”**).

❑ In contrast to popular believes, tax risks mainly arise from issues related to **poor** or lack of communication between departments and people, instead of factual or technical analysis of tax issues.

❑ **Insight-Communication**

❑ **Follow-up-Communication**


❑ **Facts Analysis-Communication**

❑ **Technical Analysis-Knowledge**

❑ From the above, it is clear that communication is critical to a tax risk management. 85% of mistakes in taxes are arising from communication.

❑ Making sure that the relevant persons understand the tax issue, the essential facts and what is needed to resolve the issue and most importantly: **Who takes ownership** requires an organization to have a tax role and responsibility matrix

Taxation and VBM

- An effective tax management can have a positive impact on shareholder value
 - VBM ➡ all decisions should be taken taking into consideration the goal of maximizing shareholder value
- 
- Taxation influences decisions managers take in a VBM environment

Kenya Transfer Pricing Legislation

Section 18(3) states

“Where a non-resident person carries on business with a related resident person and the course of that business is such that it produces to the resident person either no profits or less than the ordinary profits which might be expected to accrue from that business if there had been no such relationship, then the gains or profits of that resident person from that business shall be deemed to be the amount that might have been expected to accrue if the course of that business had been conducted by independent persons dealing at arm's length.”

Kenya Transfer Pricing Legislation

THE INCOME TAX (TRANSFER PRICING) RULES, 2006.

Kenya Transfer Pricing Legislation

Methods allowable under Rule 7

- (a) the comparable uncontrolled price (CUP) method, in which the transfer price in a controlled transaction is compared with the prices in an uncontrolled transaction and accurate adjustments made to eliminate material price differences;
- (b) the resale price method, in which the transfer price of the produce is compared with the resale price at which the product is sold to an independent enterprise;
Provided that in the application of this method the resale price shall be reduced by the resale price margin (the price margin indicated by the reseller);

Kenya Transfer Pricing Legislation

- (c) the cost plus method, in which costs are assessed using the costs incurred by the supplier of a product in a controlled transaction, with a mark-up added to make an appropriate profit in light of the functions performed, and the assets used and risks assumed by the supplier;
- (d) the profit split method, in which the profits earned in very closely interrelated controlled transactions are split among the related enterprises depending on the functions performed by each enterprise in relation to the transaction, and compared with a profit split among independent enterprises in a joint venture;

Kenya Transfer Pricing Legislation

- (e) the transactional net margin method, in which the net profit margin attained by a multinational enterprise in a controlled transaction is compared to the net profit margin that would have been earned in comparable transactions by an independent enterprise; and
- (f) such other method as may be prescribed by the Commissioner from time to time, where in his opinion and in view of the nature of the transactions, the arm's length price cannot be determined using any of the methods contained in these guidelines

Example: Scenario A

Country A

Tax rate= 60%

Selling price=300,000

Country B

Tax rate= 20%

Production Cost=
100,000

TP= 200,000

WACC=10%

	Parent (Country A)	Affiliate (Country B)	Overall
Sales	300,000	200,000	120,000
CGS	(200,000)	(100,000)	
Profit before tax	100,000	100,000	
Tax:			
Country A	(60,000)		
Country B		(20,000)	
After tax profit	40,000	80,000	
WACC= 10%			
Value= FCF/WACC	400,000	800,000	1,200,000

Example: Scenario B

Country A

Tax rate= 60%

Selling price=300,000

Country B

Tax rate= 20%

Production Cost=
100,000

TP= 250,000

WACC=10%

	Parent (Country A)	Affiliate (Country B)	Overall
Sales	300,000	250,000	
CGS	(250,000)	(100,000)	
Profit before tax	50,000	150,000	
Tax:			
Country A	(30,000)		
Country B		(30,000)	
After tax profit	20,000	120,000	140,000
WACC= 10%			
Value= FCF/WACC	200,000	1,200,000	1,400,000

Income shifting

- **84%** of the developing countries felt that the foreign affiliates operating in their countries used **income shifting** to avoid tax liability (UNCTAD Survey)
- A significant percentage of the examinations of transfer pricing transactions end with an **adjustment** (Ernst & Young)
- In a survey conducted by Ernst and Young in 2005, 53% of the interviewed companies were found to set aside a **provision for transfer pricing risk** in their financial statements

Conclusion

- TP can be used as a **tool to shift profits** between countries
- TP policies also **influence the value** of a company
- **The goal of governments** and tax authorities is to minimize their losses and fight tax avoidance
- According to a survey of Ernst & Young, a majority of companies strongly believe that transfer pricing will present **challenges in the future**

Transfer Price Documentation in Kenya

Trying to avoid Double Taxation

Goals of documentation

Goals of Tax Administrations (KRA):

- Checking correct profit per firm (in a group)
- Protecting tax revenues

Goals of Companies:

- Guaranteeing tax planning strategy of firm
- Avoiding financial risks

Documentation Requirements in Kenya

Independent expert must be able to understand and evaluate the case conditions and the price determination.

Documentation

```
graph TD; A[Documentation] --> B[Circumstances of case:]; A --> C[Reasonable Price:];
```

Circumstances of case:

- Data regarding the group.
- Description of participation.
- Data regarding relationships to business partners and close persons.
- Functions and positions of firm in the group.
- Risks of related firms and parties.

Reasonable Price:

- Which methods have been chosen and why?
- Documents on price calculation.
- Documents on comparable price data and on the adjustments included.

Documentation Requirements in other Developed countries

Taxpayer must proof that chosen transfer prices

- are reasonable
- reflect trust in comparability

Documentation

```
graph TD; A[Documentation] --> B[Main Documents:]; A --> C[Background Documentation:];
```

Main Documents:

- Data regarding the group and participation,
- Data regarding relationships to business partners and close persons
- Functions and positions of firm in the group
- Risks of related firms and parties
- Analysis of chosen methods

Background Documentation:

- Information relevant for preparation of main documents,
 - all Financial Statements
 - Price Calculations
 - Data on ownership and capital structure

International Trends in Tax Enforcement: Meeting of the Forum on Tax Administration in January 2012

1. The January 2012 meeting in Buenos Aires of the Forum on Tax Administration brought together the heads of the tax administrations from 43 countries under the auspices of the OECD and concluded with a unified and strengthened commitment to combat offshore tax abuse.
2. The tax administrators focused on the need to work smarter in times of shrinking budgets, and how to strengthen their relationship with large corporations through efficient and effective strategies that benefit both the taxpayer and taxing authority.
3. "Although there have been some high-profile successes in the fight against offshore tax abuse, resulting in significant additional tax revenues and real improvements in transparency and exchange of information, it is far too soon to declare victory."
4. The tax administrations agreed that collaboration must now include coordinated actions by countries to finally put an end to offshore non-compliance.

International Trends in Tax Enforcement: Meeting of the Forum on Tax Administration in January 2012

5. A key agreed objective was to promote the relationship between tax administrations and Large Business Taxpayers

“An adversarial relationship between tax administrations and multinational corporate taxpayers serves neither of our purposes well and is contrary to our common goals, which are earlier and greater certainty, consistency, and efficiency.”

International Trends in Tax Enforcement: OECD Guidelines for Multinational Enterprises - 2011

Part I : Recommendations for responsible business conduct in a global context Section XI – Taxation

1. Tax compliance includes such measures as providing to the relevant authorities timely information that is relevant or required by law for purposes of the correct determination of taxes to be assessed in connection with their operations and conforming transfer pricing practices to the arm's length principle." (Para 1)

2. "Enterprises should treat tax governance and tax compliance as important elements of their oversight and broader risk management systems. In particular, corporate boards should adopt tax risk management strategies to ensure that the financial, regulatory and reputational risks associated with taxation are fully identified and evaluated." (Para 2)

International Trends in Tax Enforcement: OECD Guidelines for Multinational Enterprises - 2011

Part I, Section XI – Taxation

3. In the case of enterprises having a corporate legal form, corporate boards are in a position to oversee tax risk in a number of ways. For example, corporate boards should proactively develop appropriate tax policy principles, as well as establish internal tax control systems so that the actions of management are consistent with the views of the board with regard to tax risk. (Para. 102)

International Trends in Tax Enforcement: OECD Guidelines for Multinational Enterprises - 2011

Part I, Section XI – Taxation

4. Tax authorities may need information from outside their jurisdiction in order to be able to determine the tax liability of the member of the MNE group in their jurisdiction. Again, the information to be provided is limited to that which is relevant to or required by law for the proposed evaluation of those economic relationships for the purpose of determining the correct tax liability of the member of the MNE group. MNEs should co-operate in providing that information. (Para. 103)

International Trends in Tax Enforcement: OECD Guidelines for Multinational Enterprises - 2011

Part I, Section XI – Taxation

5. Application of the arm's length principle avoids inappropriate shifting of profits or losses and minimises risks of double taxation. Its proper application requires multinational enterprises to cooperate with tax authorities and to furnish all information that is relevant or required by law regarding the selection of the transfer pricing method adopted for the international transactions undertaken by them and their related party. (Para. 104)

International Trends in Tax Enforcement:

OECD Guidelines for Multinational Enterprises - 2011

Part I, Section XI – Taxation

6. The *OECD Transfer Pricing Guidelines* aim to help tax administrations (of both OECD member countries and non-member countries) and multinational enterprises by (partially omitted) minimising conflict among tax administrations and between tax administrations and multinational enterprises and avoiding costly litigation. Multinational enterprises are encouraged to follow the guidance in the *OECD Transfer Pricing Guidelines*, as amended and supplemented, in order to ensure that their transfer prices reflect the arm's length principle. (Para. 106)

Results of Enhancing Corporate Governance Concerning Taxes

"It is beneficial for both enterprises and the tax administration when tax compliance is improved through the enhancement of corporate governance."

1. Benefits for Enterprises

- 1) Minimizing tax risks
- 2) Minimizing the burden of audit defenses in tax examinations.

2. Benefits for the Tax Administration

- 1) Greater focus on tax examinations of corporations with a high need for

Efforts by the National Tax Authorities*

“The national tax authorities will maintain and improve tax compliance through the enhancement of corporate governance by large business taxpayers, by confirming the status of corporate governance concerning taxes by large business taxpayers during tax examinations and carrying out exchanges of views with top management.”

Conducting of Orientation Sessions

“In meetings attended by top management of large business taxpayers, we will encourage the enhancement of corporate governance concerning taxes (such as by introducing examples of effective efforts).”

* “National tax authorities” refers to regional taxation bureaus, which have jurisdiction over large business taxpayers.

Efforts by the National Tax Authorities

Approaches towards Individual Enterprises

During the opportunity of a tax examination by Special Examiners in the Large Enterprise Examination Department in each regional tax bureau, the national tax authorities will confirm the status of the corporate governance concerning taxes by large business taxpayers through a request to them to describe the current status of their corporate governance including the involvement and direction by top management and the maintenance of an organization and functions in the finance and audit departments, in a “Confirmation Sheet on Corporate Governance Concerning Taxes”.

Efforts by the National Tax Authorities

Approaches towards Individual Enterprises

- 1) Upon the closing of a tax examination, the top management of a large business taxpayer and the top officials of a regional tax bureau will exchange views for the enhancement of corporate governance concerning taxes (such as by introducing examples of effective efforts).

Efforts by the National Tax Authorities

Use in Determining the Need for an Examination

“Going forward, when determining the need for an examination, the national tax authorities will utilize the status of corporate governance concerning taxes as an important decision-making material and will allocate tax examination resources more heavily toward corporations with a high need for an examination.

Efforts to Maintain and Enhance Tax Compliance in Transfer Pricing

- In order to prevent the occurrence of problems concerning transfer pricing, the national tax authorities will promote the voluntary and appropriate actions of enterprises through cooperation between the national tax authorities and the enterprises.”
- Merits for both the enterprises and the tax authorities through maintaining and enhancing tax compliance in transfer pricing

Efforts to Maintain and Enhance Tax Compliance in Transfer Pricing

Benefits for enterprises

- Minimizing tax risks
- Minimizing the burden of audit defenses in tax examinations

Benefits for the tax authorities

- Greater focus on tax examinations of corporations with a high need for an examination
- Preventing the problem of international double taxation (Mutual Agreement Procedures with foreign tax authorities)

Particular Compliance Concerns in Transfer Pricing

1. In a self-assessment system, the taxpayer is required to themselves calculate the arm's length prices for their transfer pricing and to file tax returns based on such calculations.
2. Because transfer pricing issues involve huge risks and costs, it requires even more voluntary and appropriate actions by the enterprises.
3. The importance of improving tax compliance, including transfer pricing, has been highlighted as an international trend.

Particular Compliance Concerns in Transfer Pricing

4. In foreign countries, the enforcement of transfer pricing rules has been strengthened, and it is expected that transfer pricing assessments (double taxation) and the competent authority negotiations resulting from the same will increase. Accordingly, there is an increased need to consider measures, etc. for advance prevention of double taxation.

Key Actions Expected of Enterprises to Prevent Occurrence of Transfer Pricing Problems

1. Knowledge of Transfer Pricing Legislation
2. Involvement of Top Management
3. Recognition of Status and Problem Areas in Foreign Related Party Transactions
4. Implementation of Global Transfer Pricing Policies
5. Transaction Price Setting Taking into Account Transfer Pricing Methodologies
6. Transfer Pricing Compliance of Related Parties Overseas

Based on the above, a “Check Sheet to Confirm the Status of Efforts Concerning Transfer Pricing” should be prepared.

7. (Governance by Parent Company)
8. Communications with the Tax Administration

India – Vodafone Int’l Holdings B.V. v. Union of India (Supreme Court, Jan. 20, 2012)

SUMMARY:

- Vodafone, a U.K. telecommunications company, purchased an Indian mobile phone company from a Hong Kong-based company for \$11.2 billion in 2007.
 - Indian tax authorities assessed \$2.2 billion in capital gains tax against Vodafone in connection with the transaction, claiming that
 - The Bombay High Court ruled in favor of the CBDT in 2010.

STATUS:

- In January 2012, the Supreme Court reversed, holding that in the absence of a specific look-through provision in India’s domestic law, a sale of shares by companies outside of India cannot be taxed by India simply because the underlying assets are located in India.
 - The Supreme Court stated that allowing taxation under these circumstances “would amount to imposing capital punishment for capital investment since it lacks authority of law.”

India – Vodafone Int’l Holdings B.V. v. Union of India (Supreme Court, Jan. 20, 2012)

AFTERMATH:

- On February 17, 2012, Indian tax authorities filed a petition with the Supreme Court requesting a review of the January decision. The Supreme Court rejected the petition on March 20, 2012.
- However, in March 2012 the government proposed amendments to the Income Tax Act that would permit the retroactive taxation of cross-border transactions involving assets located in India.
- Separately, in December 2011, Vodafone was subject to a \$1.7 billion transfer pricing assessment in India. It recently filed an appeal citing certain favorable observations in the above-mentioned Supreme Court decision.

FUTURE OF TRANSFER PRICING

■ Where are we headed?

DISCUSSION

- “Most Appropriate Method” Rule
- Use of Comparative Methods vs. Profit Methods
- Documentation Requirements
- Enforcement Approaches
- Cooperation Among Tax Authorities
- Litigation
- MAPs and APAs
- Transfer pricing and customs

Example of Home Policies

	Exemption	Credit	Deduction	Double Tax
Foreign Income	\$1000	\$1000	\$1000	\$1000
Foreign Taxes Paid	\$350	\$350	\$350	\$350
Home Taxes Paid	\$0	\$100	\$293	\$450
Net Income	\$650	\$550	\$357	\$200

Peripatetic prefers tax exempt policy. Beyond that, tax credit over deduction, and prefers either of these over double taxation.

Tariffs and Transfer Pricing

Tariffs are additional costs imposed on goods and services imported to a country.

Management can minimize import duties paid by setting transfer prices as low as possible. Tariffs are levied on the transfer prices selected and are deductible expenses in figuring the branches' income taxes.

Summary of Tax Management Principles

Decision	No Excess Tax Credits	Excess Tax Credits
Cost Allocation	Does not matter	Allocate costs to high-tax countries
Transfer Pricing	Does not matter	Show profits in low-tax countries
Transfer Pricing with Tariff	Low transfer price	Minimize total taxes by high transfer price

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1. Knowledge of Transfer Pricing Legislation
2. Involvement of Top Management
3. Recognition of Status and Problem Areas in Foreign Related Party Transactions
4. Implementation of Global Transfer Pricing Policies
5. Transaction Price Setting Taking into Account Transfer Pricing Methodologies
6. Transfer Pricing Compliance of Related Parties Overseas (Governance by Parent Company)
7. Communications with the Tax Administration

Based on the above, a “Check Sheet to Confirm the Status of Efforts Concerning Transfer Pricing” should be prepared.

Medtronic Inc. v. Comm'r, **T.C. No. 6944-11**

STATUS:

- Medtronic Inc. filed a petition in the Tax Court on March 23, 2011, challenging \$2.7 billion in upward income adjustments to its 2005 and 2006 taxable years.
 - Approximately \$1.4 billion of the adjustments were transfer pricing adjustments related to licensing and manufacturing transactions with Medtronic's affiliates in Switzerland and Puerto Rico.

CUSTOMS AND TRANSFER PRICING: WHAT YOU SHOULD BE AWARE OF

- “Customs” reactions
 - Importance of well-accepted customs rules adopted on multilateral basis under GATT
 - Skepticism of “profit methods” in transfer pricing
 - Most inter-company transactions are accepted under “transaction value” method anyway.
- Specific challenge: Use of profits-based method (e.g., TNMM) that requires prospective or retroactive pricing adjustments to reach profit targets. Acceptable for customs? What procedures?
- Any convergence in transfer pricing and customs practices in Asia countries?

FUTURE OF TRANSFER PRICING

- Where are we headed during the next 5 years?

PANEL DISCUSSION

- “Most Appropriate Method” Rule
- Use of Comparative Methods vs. Profit Methods
- Documentation Requirements
- Enforcement Approaches
- Cooperation Among Tax Authorities
- Litigation
- MAPs and APAs
- Transfer pricing and customs

Questions

Thank you!

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