



TransferPricingNews

BDO Seidman, LLP
Accountants and Consultants

ISSUE:

NEW PROPOSED U.S. TRANSFER PRICING SERVICE REGULATIONS

DATE:

On September 10, the IRS proposed new transfer pricing regulations, which could have a significant impact on the U.S. and foreign taxpayers involved in the cross-border provision of intercompany services. The IRS expects to receive written comments by December 9, 2003.

DETAILS:

The proposed regulations provide guidance on the treatment of controlled service transactions under Section 482, and specifically, the allocation of income from and ownership of intangible property among affiliated companies.

The objectives of the proposed regulations are: (1) to establish new methodologies to evaluate whether the intercompany service transactions comply with the arm's-length principle, (2) to determine the ownership of intangible property used by controlled parties, and (3) to establish the arm's-length consideration for a contribution by one controlled party to develop or enhance intangible property owned by another controlled party. The regulations propose four new methods for evaluating the arm's-length nature of intercompany services.

The IRS would divide intercompany services into two categories:

(i) high margin, core functions, such as manufacturing, production, distribution, and research and development-related services, and (ii) low-margin intercompany services, such as administration functions.

With respect to the high margin, core profit-making functions (where net cost plus markup is greater than 10 percent), a full transfer pricing analysis should be conducted in order to determine arm's-length service prices.

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DETAILS (continued...)

For low-margin intercompany services (i.e., non-core services for which an arm's-length net cost plus markup is not greater than 10 percent), a new simplified cost-based method can be applied at the discretion of a taxpayer, under which the comparable profits method is deemed to be the best method. Taxpayers are encouraged to perform a transfer pricing analysis to develop more appropriate arm's-length markups.

Although taxpayers can charge expenses related to the provision of intercompany services with no profit markup, the IRS may propose a transfer pricing adjustment if it determines that an arm's-length net cost plus markup should be greater than 6 percent.

In addition, taxpayers may be advised to perform a detailed analysis of the allocation of costs pertaining to the provision of intercompany services to determine the appropriate basis of total service costs since they may be subject to a transfer pricing adjustment even if the charged markup is deemed arm's-length.

Finally, taxpayers who develop valuable intangible property, and provide intercompany services that enhance or utilize this property, may face additional scrutiny from the IRS if the development of the intangible property is not clearly performed by the entity that owns it.

RECOMMENDED ACTION:

Multinational corporations should carefully review intercompany agreements pertaining to the provision of services and the use and development of intangible property to ensure compliance with the proposed new rules, and to optimize intercompany pricing structures. Pursuing this initiative will help companies avoid a potential reassessment of income and the burden of associated penalties and double taxation.

HOW BDO CAN HELP:

Our transfer pricing consultants can help you:

- Analyze your existing transfer pricing agreements and protocols;
- Recommend defensible, arm's-length methodologies; and
- Help implement the most tax-efficient methodology in light of the proposed new rules.

Material discussed in this newsletter is meant to provide general information and should not be acted on without obtaining professional advice tailored to your firm's individual needs.



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