Transfer pricing used to be a somewhat arcane area of tax, governing how multinational corporations structured, priced, and documented their intercompany transactions. Often, transfer pricing was relatively low on the priority list of tax departments, and transfer pricing issues rarely rose to the interest level of the C suite. But no more! Heightened compliance and transparency requirements, along with growing interest by tax authorities in protecting their local tax base, have led to multinationals coming under increased public scrutiny with respect to their international structures and transfer pricing practices.

Organisation for Economic Cooperation and Development

The OECD BEPS initiative consists of 15 “actions” issued by the OECD to assist governments in addressing perceived “base erosion and profit shifting” (BEPS) by taxpayers, with a goal of ensuring that profits are taxed in the jurisdictions where value is created. Many of those actions directly or indirectly impact transfer pricing policies and compliance.

Multinationals are now required to prepare and maintain more extensive transfer pricing documentation and to do so for many more countries than before. Under BEPS Action 13, the OECD countries and many others have introduced country-by-country reporting, which provides tax authorities more transparency into a multinational’s worldwide affairs through information on revenue from unrelated and related parties, taxes, and other indicators of economic activity, by jurisdiction. This information is expected to drive increased transfer pricing enforcement, and combined with inconsistencies in interpretation across jurisdictions, it is expected to drive increased controversy.

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GILTI stands for Global Intangible Low-Taxed Income and subjects U.S. multinationals’ non-U.S. income earned through controlled foreign corporations to current U.S. taxation. FDII stands for Foreign-Derived Intangible Income and provides a lower effective tax rate for U.S. exports of products, intangibles, and services. BEAT stands for Base Erosion and Anti-abuse Tax and functions effectively as an alternative tax based on deductible payments made by U.S. taxpayers to related parties overseas. These new U.S. tax rules are complex, and the interaction among them and with prior existing tax regulations can lead to very different outcomes for taxpayers depending on their facts.
Rethinking transfer pricing

The historic U.S. statutory tax rate of 35 percent was among the highest in the OECD countries, leading multinationals to structure their intercompany transactions and policies to minimize income subject to the high U.S. tax rate.

With U.S. tax reform, multinationals are increasingly reevaluating their international structures and looking for opportunities to take advantage of the lower U.S. tax rates. This change in focus is a result of the new U.S. statutory tax rate of 21 percent, which is lower than the average rate for OECD countries; the end of deferral on current U.S. taxation of overseas income; and new provisions such as FDII that “reward” U.S. exports of property and services.

**Take advantage of FDII**

Whereas in the past, many multinationals did not charge their overseas affiliates for their corporate trademark or brand, many are now rethinking that position. And there is justification to do so; in today’s competitive landscape with many more globally ambitious players from both developed and developing nations, brands and brand reputation are becoming increasingly important to winning in the marketplace. Multinationals are incurring significant expenditures in developing their brands and may have justification to charge affiliates who use the brand in their local markets. And even when brand expenditures are relatively minimal, the brand may still have significant market value.

A U.S. multinational charging its foreign affiliates for the use of its brand would have that royalty income subject to taxation at a lower effective rate of 13.125 percent to 16.406 percent to the extent the royalty is FDII eligible income, which is significantly lower than the new U.S. statutory rate of 21 percent. In addition, given the complex manner in which the U.S. tax rules operate, increasing royalty income in the United States may in some cases provide for an additional tax benefit through increased utilization of credits on foreign taxes paid.

There are a number of other areas where a U.S. multinational (or U.S. subsidiary of a foreign multinational) can avail itself of the lower FDII tax rate, such as where a U.S. entity develops technology or process intangibles it licenses or otherwise makes available to overseas affiliates, or provides corporate support or other services to overseas affiliates.

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6 Under FDII, certain income from the sale of property and services to non-U.S. entities/persons qualifies for a deduction that lowers the effective U.S. tax rate on that income to 13.125 percent through 2025 and to 16.406 percent thereafter. The lower tax rate on FDII eligible income, with some exceptions, is also available to the export of property and services by U.S. multinationals (or U.S. subsidiaries of foreign multinationals) to overseas affiliates.

7 The issue of foreign tax credit utilization is complex and outside the scope of this article. But at a simplistic level, foreign-earned income of a U.S. multinational is taxable in the country where it is earned and may also be taxable in the United States under the subpart F or GILTI provisions of the U.S. tax rules. The multinational may receive a U.S. tax credit for the foreign taxes paid on foreign income that falls under the subpart F or GILTI provision. But the foreign tax credits are limited by various factors, such as (but not exclusively) the amount of foreign source income recognized by the U.S. corporation and the allocation of certain corporate and other expenses to the foreign income.
Adjust intercompany pricing
Even when the U.S. entity is currently charging for such intangibles or services, there may be opportunities to revisit the method or quantum of those charges. Transfer pricing requires that intercompany transactions be priced at arm’s length or, in layman’s terms, at a market price, benchmarked against how comparable transactions are priced among unrelated parties. Perfect comparables rarely exist; there is usually not a single arm’s-length price but rather a range of prices that could be supported as arm’s length. Changing business conditions generally support periodic reviews of pricing policies and appropriate comparables, and adjustments to the transfer prices can be made with attention to the tax impact under the new U.S. tax rules.

Intangibles approach
Where a multinational has previously migrated intangible rights or other high-value activities offshore, U.S. tax reform may lead to tax liability under GILTI and BEAT or a failure to take advantage of potential FDII opportunities. Consequently, a couple of questions arise. First, should the existing intangibles and/or activities be migrated back onshore? Second, should future new intangibles be developed and/or acquired overseas or in the United States? The answers to these questions are very fact dependent, but those answers may very well differ in 2018 from what they would have been in 2017.

Tax reform and BEPS
The new U.S. tax rules may also influence international tax planning a company is doing as a result of the OECD BEPS initiative. For example, part of the OECD BEPS guidance is that intangibles’ profit should accrue to those countries where a multinational undertakes the functions to develop, enhance, maintain, protect, and exploit the intangibles (also referred to as “DEMPE” functions) and not merely to the entity that contractually owns the intangible rights. Where a multinational has previously migrated intangibles offshore but has not taken steps to have sufficient economic substance or DEMPE functions in that offshore entity, the BEPS guidance likely motivates revisiting the company’s position on the economic ownership of the intangibles. U.S. tax reform provisions may make inbounding the intangibles into the United States an option worthy of serious consideration.

Other considerations
Finally, there has been a discussion that some of the new U.S. tax provisions, such as FDII or BEAT, might not survive in the long run due to political or budgetary considerations or objections from the World Trade Organization (WTO) or other international bodies. It is also possible that the U.S. statutory tax rate might, in the future, inch up from 21 percent or that other countries might change their tax laws. Even with these uncertainties, taxpayers may find it worthwhile to undertake planning to take advantage of FDII or other provisions of the new U.S. tax law.

Conclusion
The new U.S. tax rules are complex and interact among themselves and with prior regulations in complex ways. As a result, a planning opportunity that works well for one multinational may not work as well or at all for another. However, there are some international tax planning opportunities, such as those discussed above, that are promising for many multinationals, including those that have not historically been very proactive in tax planning.
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