

**A transfer pricing case study  
25, 26 & 27 July 2018  
based on an example by BDO**

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**lecturers  
Advanced Diploma in TP**

# GETTING TO KNOW FANCYFEET

- ▶ FancyFeet-US starts out as a small shoe company in the United States.
- ▶ FancyFeet-US performs all of its own design, manufacturing, marketing, distributing, etc. in the United States.
- ▶ FancyFeet-US is growing and its management decides to expand to the UK.
- ▶ Post-expansion functions that FancyFeet-US performs are going to change.

SPECIALIZED TAX SERVICES

# START WITH A SIMPLE TRANSACTION



FancyFeet-US manufactures  
and distributes shoes in the  
US



FancyFeet-UK distributes  
shoes to third-party  
customers in Europe.

What is the transaction taking place between the US and the UK?

# START BY CONSIDER THE TYPE OF TRANSACTION

## Transfer of tangible property (goods)



Raw materials, work-in-progress, kits, finished goods

## Provision of financing



Loans, guarantees, cash pooling, insurance, leasing, trading

## Provision of services



R&D, selling, distribution, logistics, manufacturing

## Transfer and use of intangible property



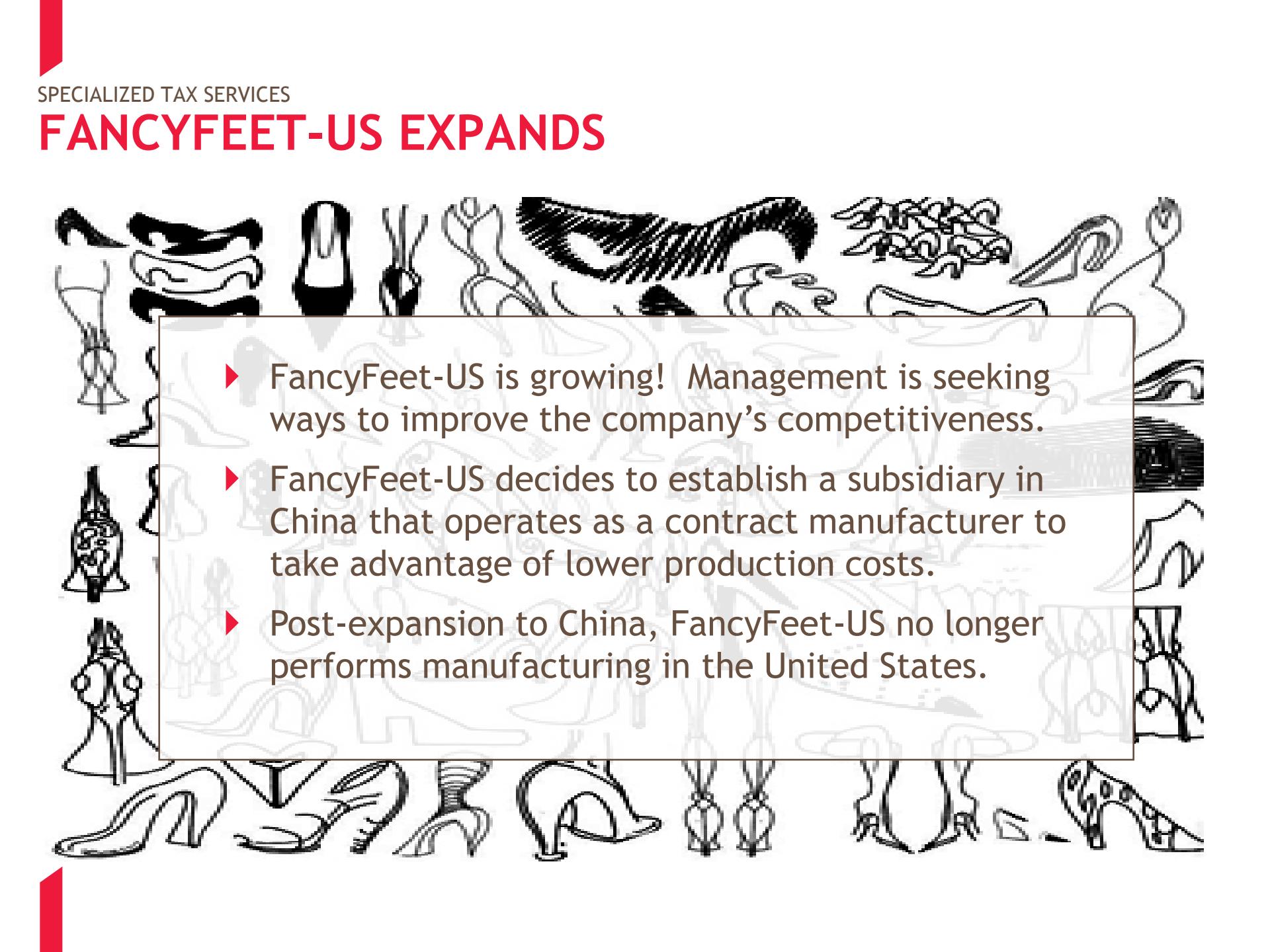
tax valuation and platform contribution of technology, know how, trademarks, etc.

# THE UK GETS SHOES AND PAYS THE U.S.



It's a tangible transaction. FancyFeet-US sells shoes to FancyFeet-UK. FancyFeet-UK should pay FancyFeet-US for the tangible goods. The price needs to be consistent with the **Arm's-Length Standard**. This price is determined through **Transfer Pricing**.

# FANCYFEET-US EXPANDS

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- ▶ FancyFeet-US is growing! Management is seeking ways to improve the company's competitiveness.
  - ▶ FancyFeet-US decides to establish a subsidiary in China that operates as a contract manufacturer to take advantage of lower production costs.
  - ▶ Post-expansion to China, FancyFeet-US no longer performs manufacturing in the United States.

# THE US AND CHINA



FancyFeet-US is an entrepreneur.

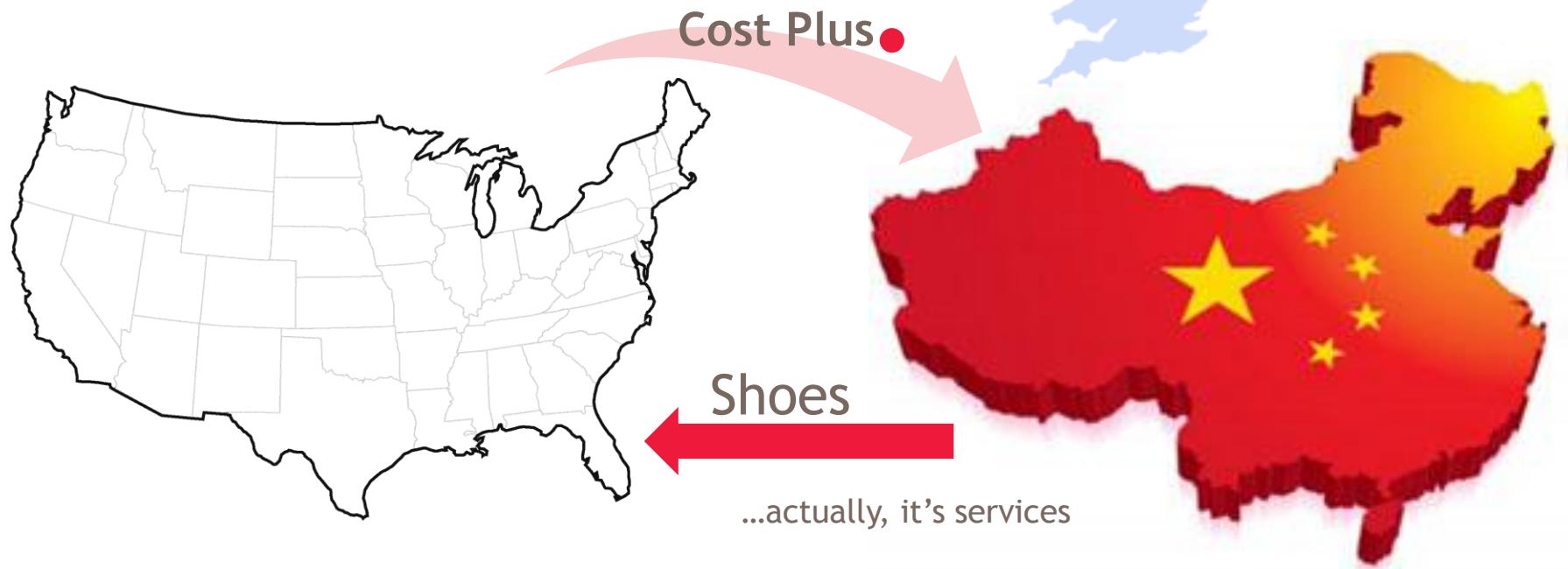


FancyFeet-China is a contract manufacturer.

What is the transaction taking place between the US and China?

(You can assume that the US still sells shoes to the UK for distribution into the European market.)

# THE US AND CHINA

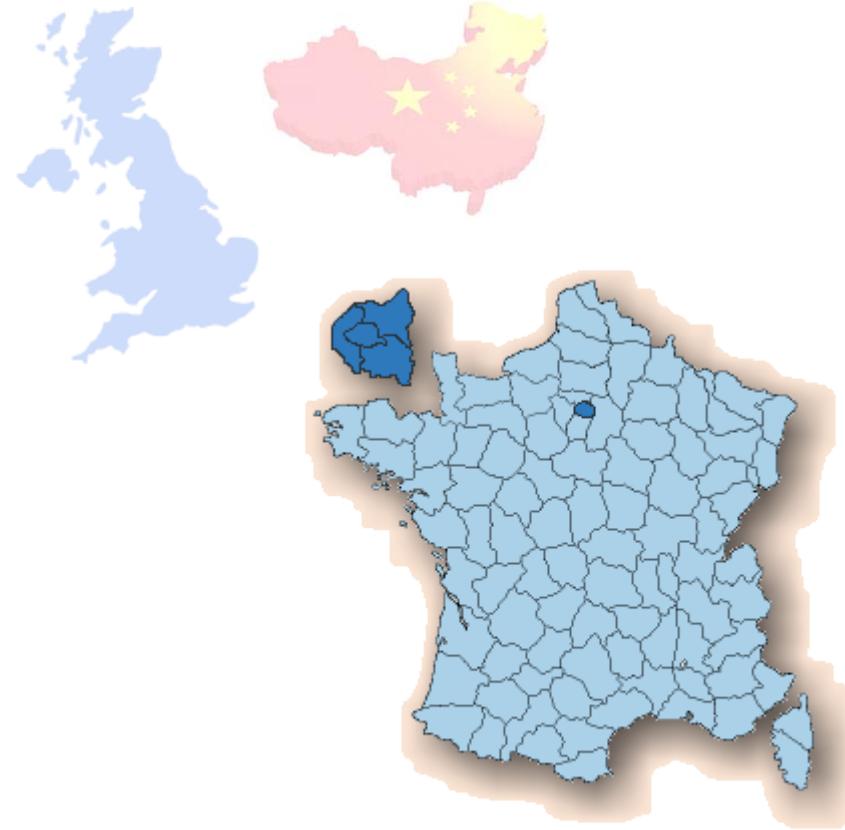


FancyFeet-China provides FancyFeet-US with finished shoes. In exchange, FancyFeet-US should pay FancyFeet-China for the manufacturing services it provides. This price for services needs to be consistent with Arm's-Length Standard.

# FANCYFEET'S EUROPEAN BUSINESS GROWS

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- ▶ FancyFeet brand is becoming extremely popular in Europe.
  - ▶ To be able to reach customers in Europe faster, FancyFeet-US opens a full-risk manufacturing company in France.
  - ▶ For logistical reasons, it is both cheaper and more efficient for FancyFeet-UK to buy manufactured shoes from FancyFeet-France.
  - ▶ FancyFeet-US will now sell to third-party customers in the US only.
  - ▶ FancyFeet-France will manufacture and sell its products to FancyFeet-UK.
  - ▶ FancyFeet-US still owns the manufacturing intellectual property (“IP”) and designs to be used by FancyFeet-France to manufacture the shoes.
  - ▶ FancyFeet-US will still use FancyFeet-China to manufacture shoes for the US market.

# THE US AND FRANCE

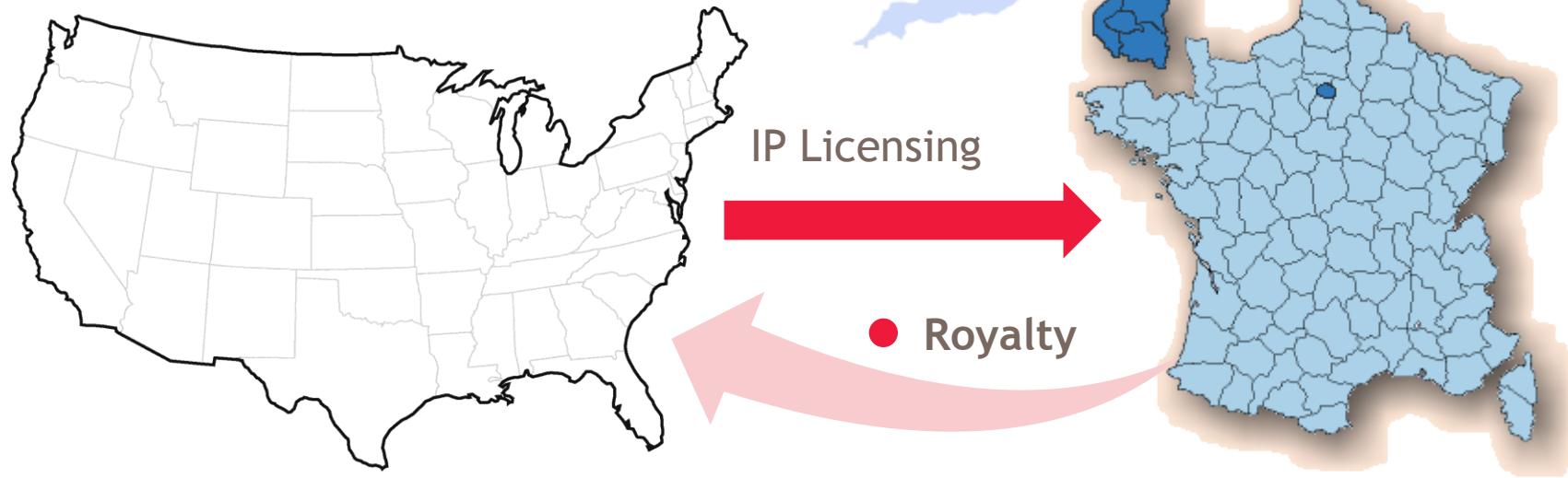


FancyFeet-US owns the IP  
needed to manufacture shoes.

FancyFeet-France is a newly  
created full-risk manufacturer.

What is the transaction between the US and France?

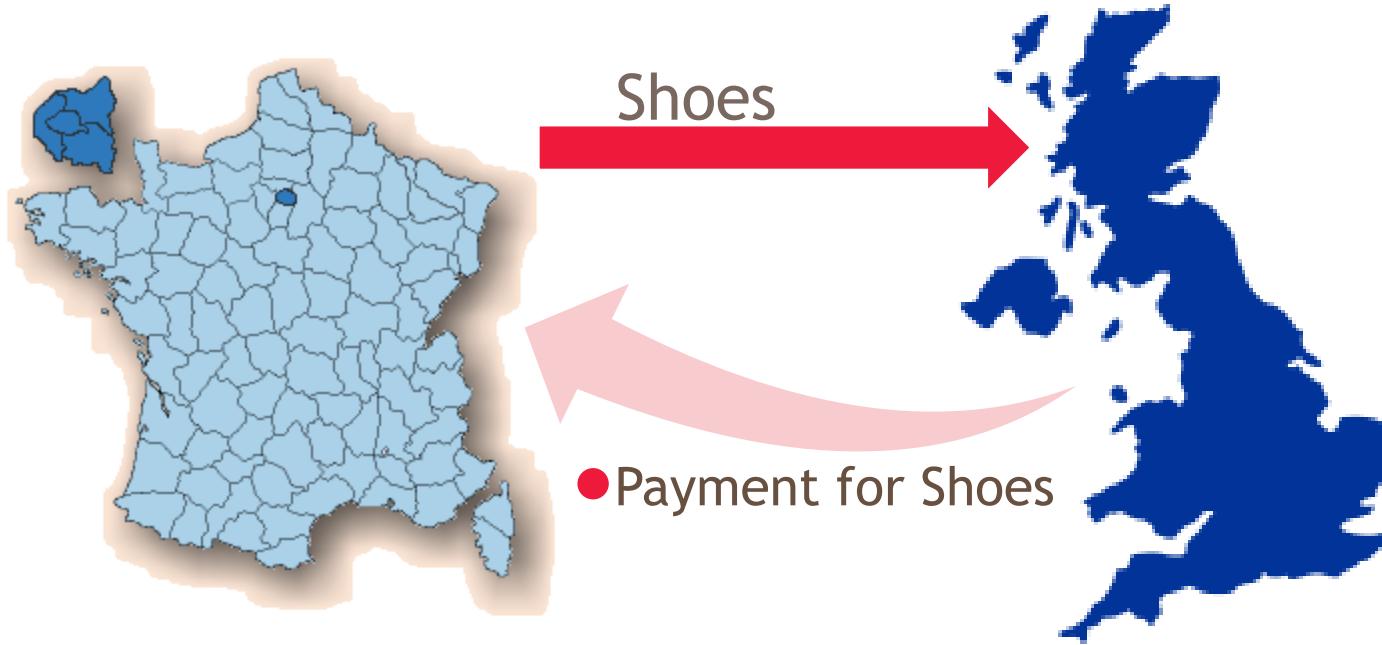
# THE US AND FRANCE



FancyFeet-France licenses manufacturing IP from FancyFeet-US. FancyFeet-France should pay FancyFeet-US royalty for use of the IP. This payment needs to follow the Arm's-Length Standard.

Apart from the other transactions that we've discussed, do you see any other transactions? Hint: Think about the UK...

# FRANCE AND THE U.K.



For convenience, FancyFeet-UK will buy from FancyFeet-France instead of FancyFeet-US. In turn, FancyFeet-UK should pay FancyFeet-France for the tangible goods. This payment must be consistent with Arm's-Length Standard.

# FANCYFEET NEEDS TO BE MANAGED CENTRALLY

- ▶ The group of FancyFeet entities is growing! Management is finding that much of the administrative burden sits with the US entity, but the US entity is not compensated.
- ▶ FancyFeet-US decides to charge the subsidiaries for the management services it provides. These management services include general administrative functions like bookkeeping, human resources, legal, and other similar functions.
- ▶ If FancyFeet US were not providing these services to its related parties, the recipients would have to go out and purchase these services from third parties.

## THE US AND THE OTHER ENTITIES

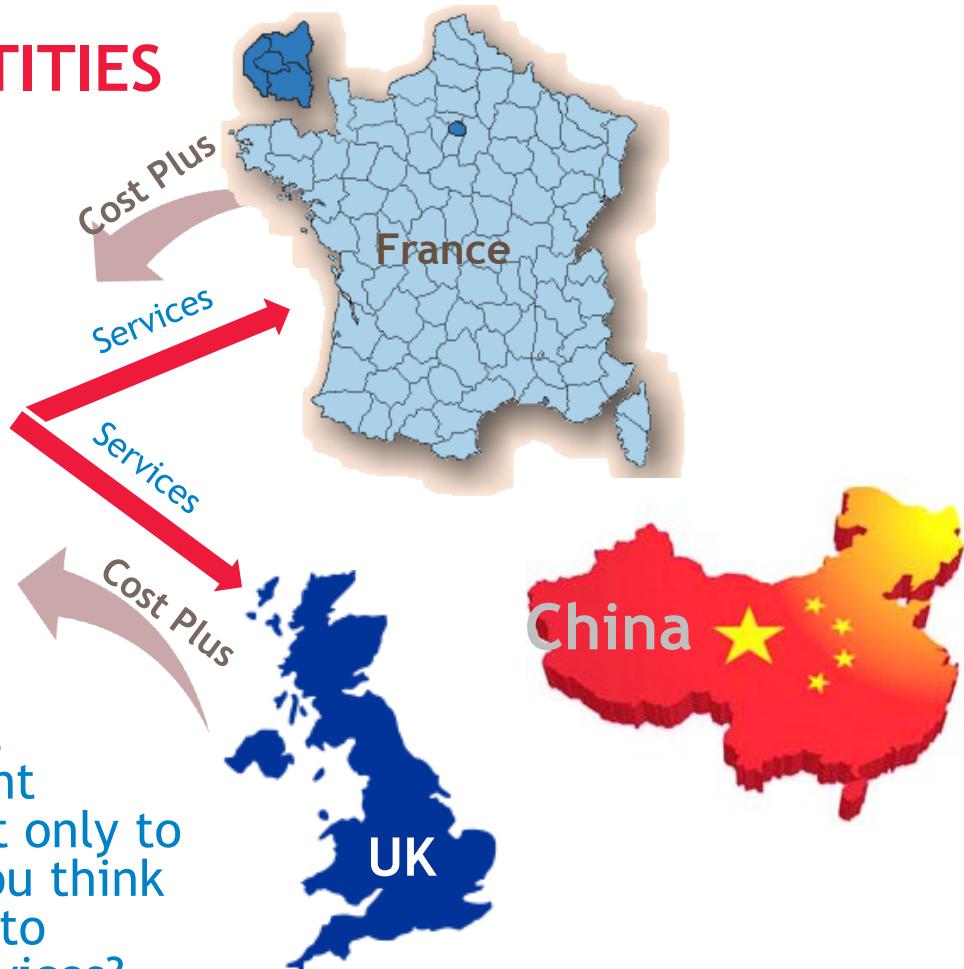


FancyFeet-US provides general administrative and management services to related parties.



This one is a little bit tricky. What is the transaction?  
Which entities would be included in this transaction?

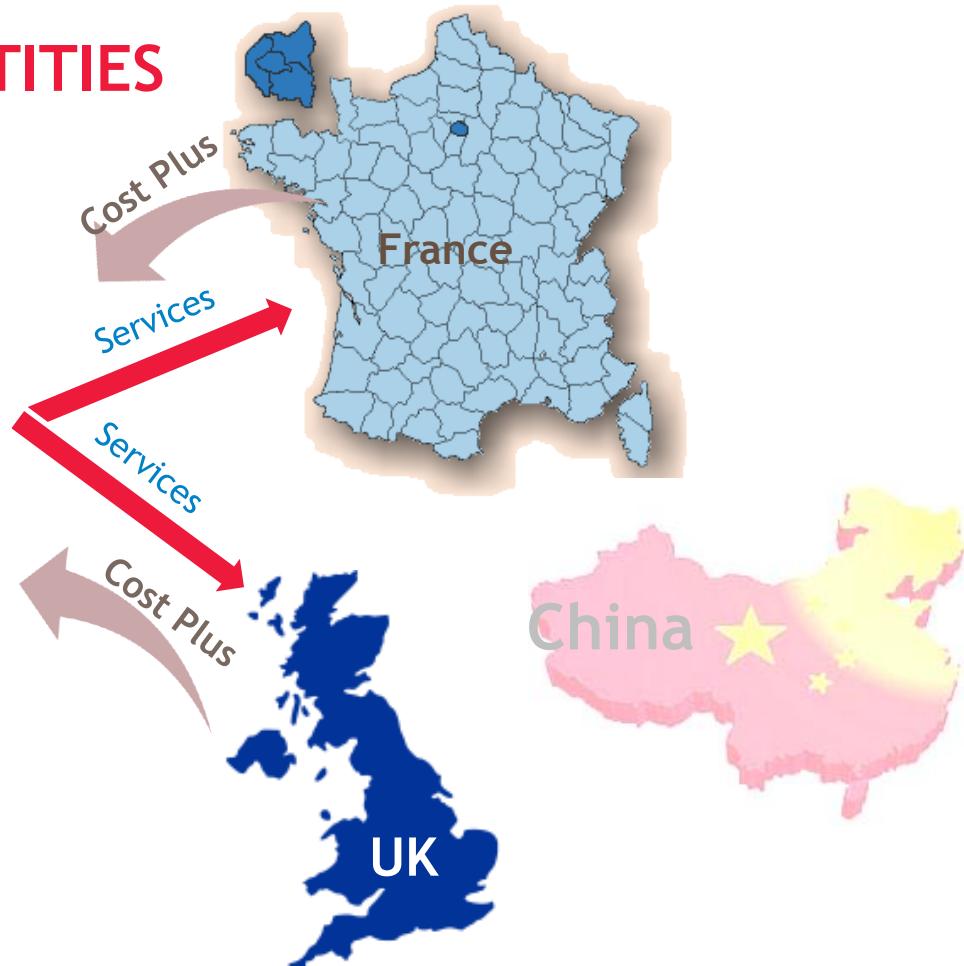
# THE US AND THE OTHER ENTITIES



FancyFeet-US provides general administrative and management services to related parties, but only to France and the UK. Why do you think it is that China wouldn't need to compensate the US for the services?

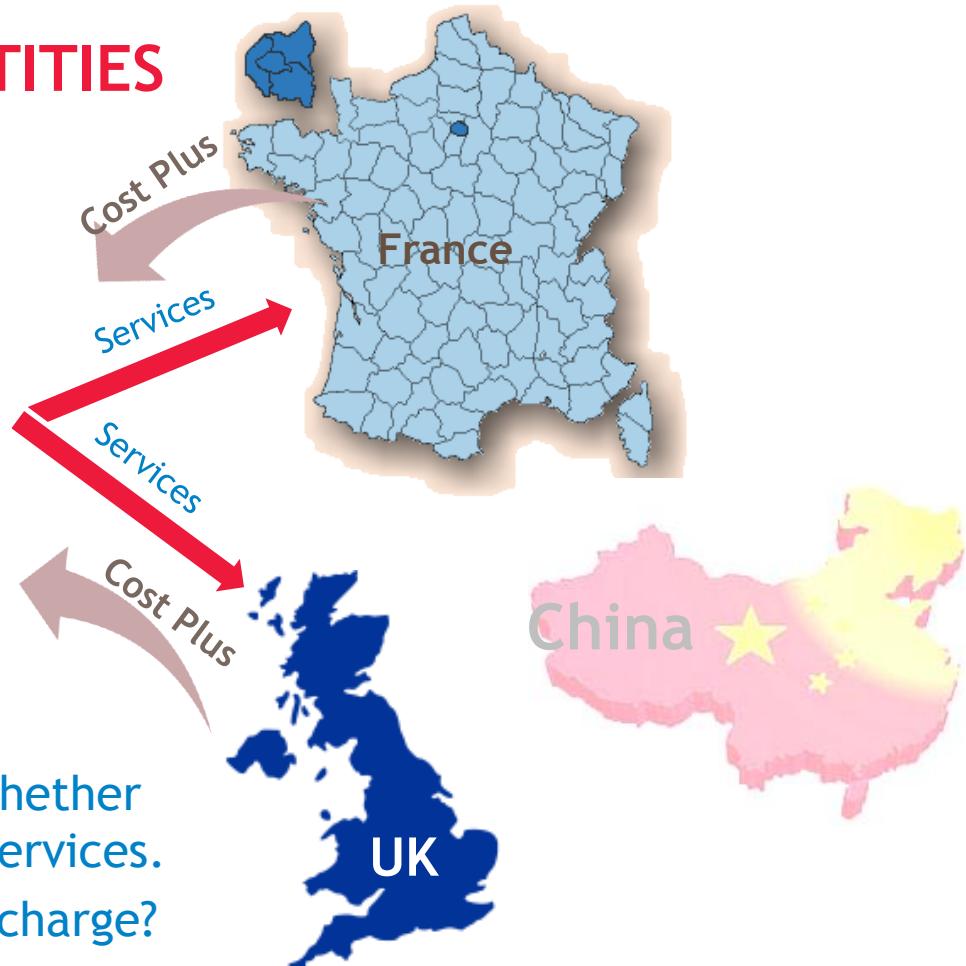
China is a contract manufacturer. It is compensated on a cost-plus basis, so charging them for management would “round trip” the costs. We typically do not charge a captive service entity a markup for management services.

# THE US AND THE OTHER ENTITIES



How much should FancyFeet-US charge FancyFeet-France and FancyFeet-UK for the services?

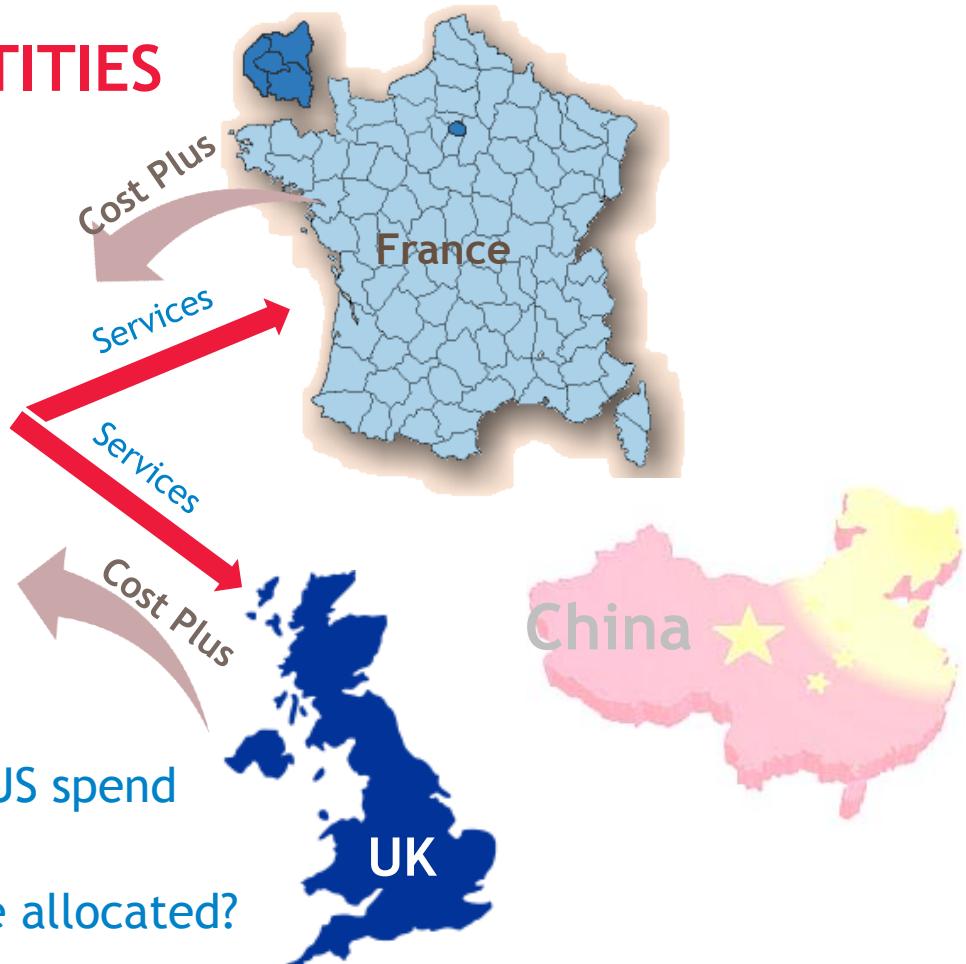
# THE US AND THE OTHER ENTITIES



FancyFeet-US must determine whether France and UK benefit from its services.  
How much should FancyFeet-US charge?

What type of data would FancyFeet US need to collect?

# THE US AND THE OTHER ENTITIES



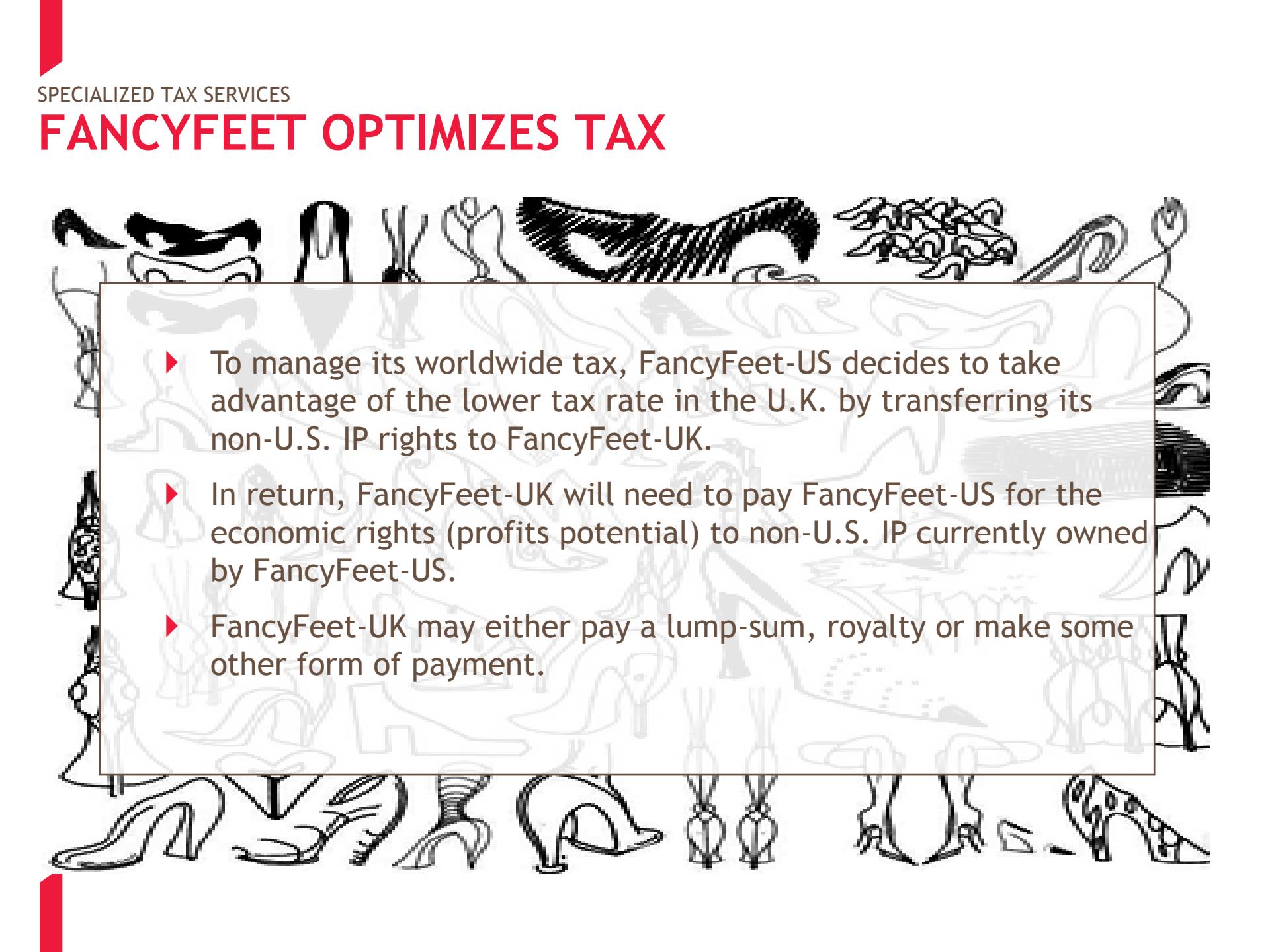
How much time or \$ did FancyFeet US spend directly on each entity?

On what basis should any balance be allocated?

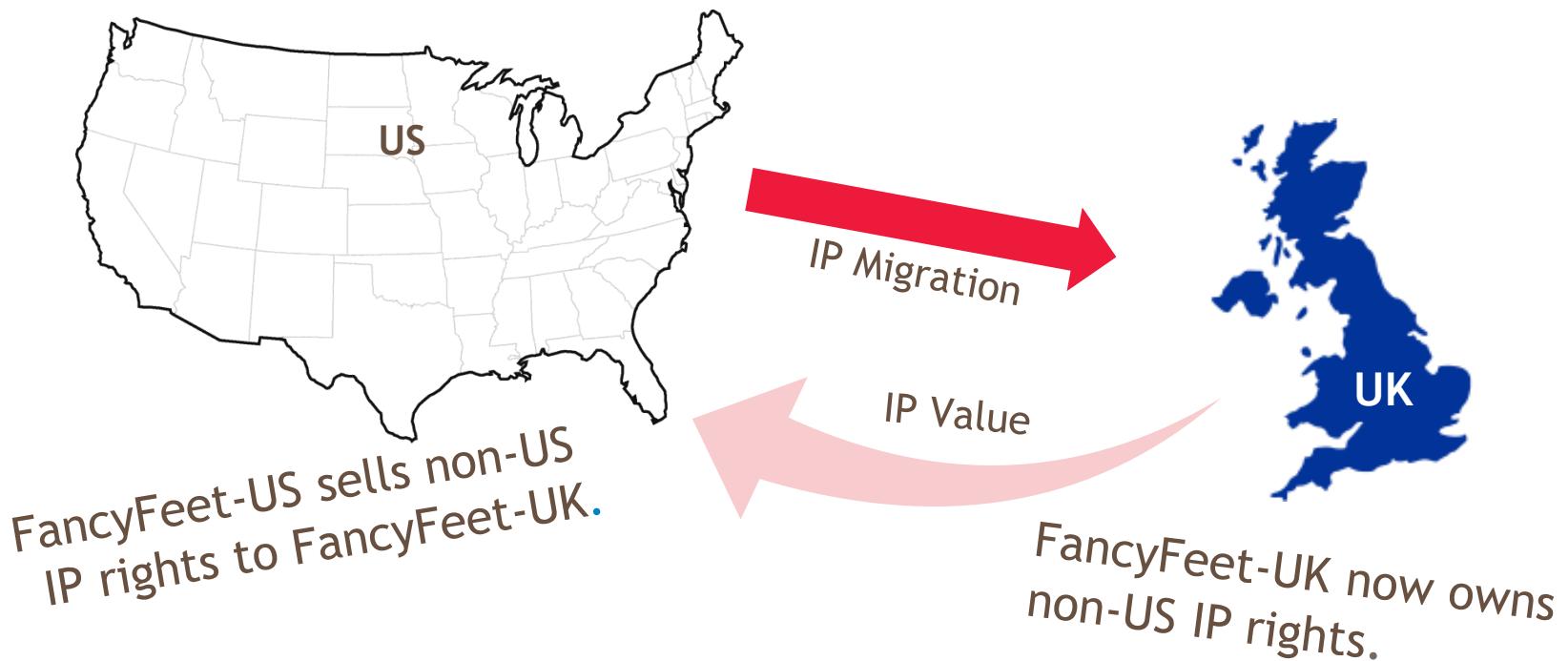
Should there be a markup?

The service fee (cost allocation) that FancyFeet-US charges must be consistent with the Arm's-Length Standard.

# FANCYFEET OPTIMIZES TAX

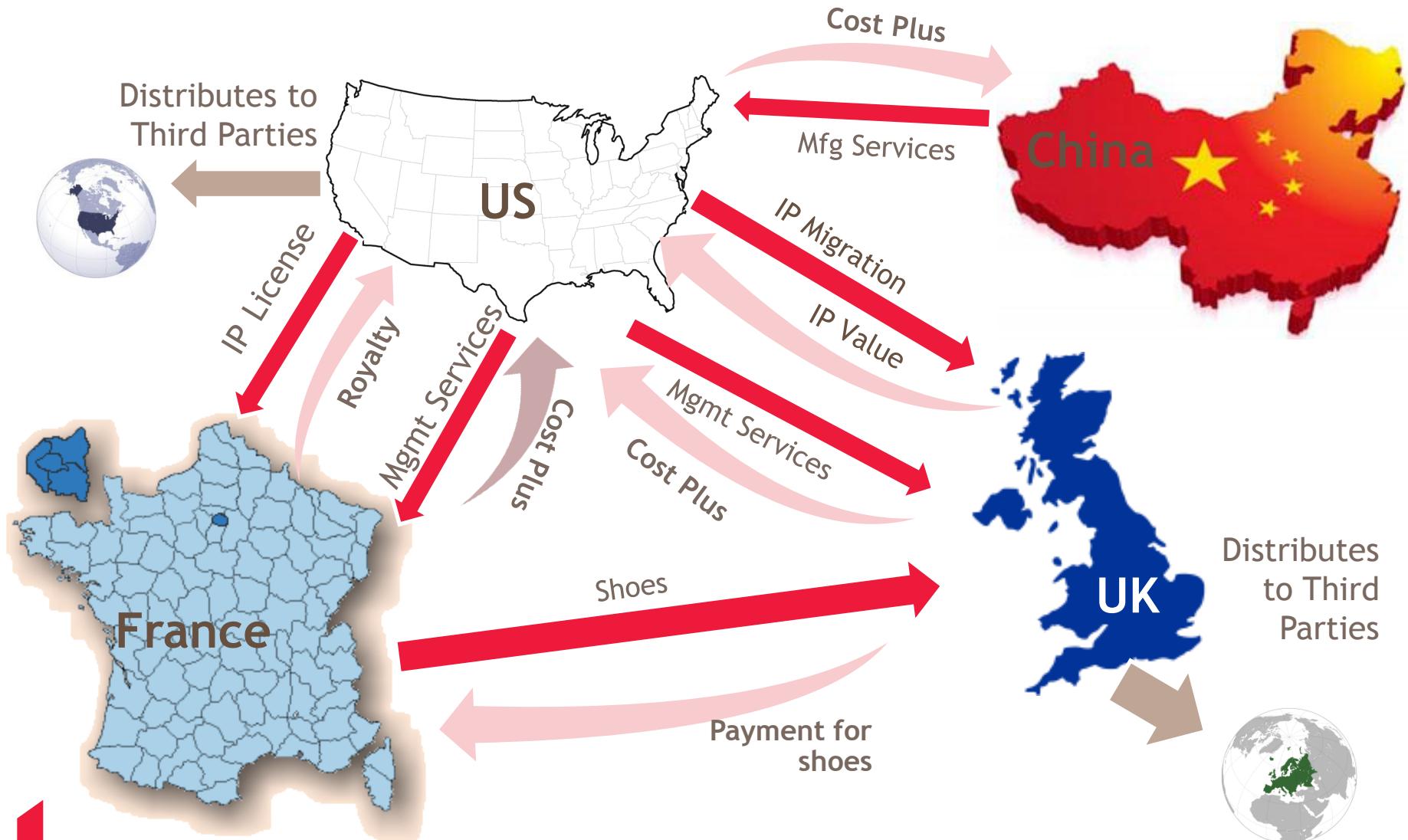
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- ▶ To manage its worldwide tax, FancyFeet-US decides to take advantage of the lower tax rate in the U.K. by transferring its non-U.S. IP rights to FancyFeet-UK.
  - ▶ In return, FancyFeet-UK will need to pay FancyFeet-US for the economic rights (profits potential) to non-U.S. IP currently owned by FancyFeet-US.
  - ▶ FancyFeet-UK may either pay a lump-sum, royalty or make some other form of payment.

# THE US AND THE UK



The IP value payment must be consistent with Arm's-Length Standard.

# AN OVERVIEW OF FANCYFEET INTERCOMPANY TRANSACTIONS



# TRANSFER PRICING SERVICES

## Planning

- Intangible holding company structures
- Intangible property valuations, buy-in payments
- Cost-sharing arrangements
- Supply chain planning
- Capital structure analysis
- Effective tax rate analysis

## Operational Transfer Pricing

- Optimization of cross charges
- Transaction posting
- Reporting
- Profitability analysis

## Compliance

- Documentation studies (global and country-specific)
- Advance Pricing Agreements
- Intercompany policy and implementation guidelines

## Audit Defense

- Tax authority response and negotiation
- Dispute resolution
- Competent authority submissions
- Litigation support and testimony