

On boarding a new transfer pricing client

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One of the fundamental challenges when starting a transfer pricing engagement with a new client is acquiring a good general understanding of their business – and securing sufficient details about their operations – in order to develop the appropriate transfer pricing policy and methodology.

Many micro-multinational small and medium-sized businesses (SMEs) are generally unfamiliar with the technical language customarily used by the tax organisations of large multinationals. In other words, the tax departments for large multinationals are the ones who usually deal with these issues via their accounting firms. In micro-multinationals, on the other hand, there are seldom accounting departments, so their COOs or CEOs must deal with these tax matters.

In order to enable communication and employ language that is familiar to business owners and entrepreneurs, tools are required that speak the language of business rather than that of tax regulations. One such tool that we have found particularly useful is the business model template devised by [Alex Osterwalder](#), the Swiss business theorist.

Based on his PhD thesis in Management Information Systems from the University of Lausanne, Osterwalder's business model was designed to help entrepreneurs who are starting a new business to describe, design, challenge, as well as document and reinvent, existing business models. [The model](#) is essentially a visual chart that describes a firm's or product's value proposition, its infrastructure, customers, and finances. Its aim is to help companies align their actions by indicating possible trade-offs. As a bonus, Osterwalder's model also serves as a good foundation

for understanding a business for the purpose of transactions taxes – evaluating 'nexus' for state and local tax (SALT) purposes in the USA. Nexus is defined as 'sufficient physical presence' or connection with a state that would allow such state to impose taxes on the out-of-state company. Through Osterwalder's model, connections become visible. Performing both exercises – transfer pricing and SALT evaluation – together allows a client to see the total picture and make suitable trade-offs.

The Osterwalder model contains nine elements which, taken together, provide a coherent view of the business along with the key drivers. First is the 'value proposition', which identifies:

- The problem you are solving, or the needs you have identified
- Why you are uniquely positioned to solve the problem or satisfy the needs
- Why your customers prefer your solutions to those of your competitors.

On the customer revenue side, there are four components:

- Customer segment
- Customer relationships
- Business channels
- Revenue streams.

In discussing these variables, one can discover how a business defines and acquires its clients. Is the customer acquired remotely, from outside the country? Is there a very long sales cycle with many 'hands' involved in the process? Are business partners used as agents to drive sales?

Such discussions will create a profile of whether 'comparable uncontrolled transactions' exist; how much value is generated by

the sales organisation; and whether connections for SALT purposes are being created by the sales process and sales support functions. Finally, what are the tax consequences of various revenue streams (services, sales or royalties)?

On the cost side, there are also four components:

- Key activities
- Key resources
- Key partnerships
- Cost structure.

Which activities are the most important in delivering the value proposition to the customer and which resources will be required? Distribution? Ongoing customer support? Acquisition or use of intellectual property? Existence of legacy relationships generated by a related party? Role of partners in assisting you to deliver the solutions to your customer?

These discussions will familiarise the client with the key elements of transfer pricing and will illustrate how various related parties will work together to contribute to the success of the global enterprise. Many of the important 'covered transactions' that will have to be evaluated in order to establish 'arm's length' prices will begin to be revealed.

Having established the necessary communication framework, it is then appropriate to begin the systematic task of defining each legal entity in terms of the criteria:

1. The functions undertaken by employees or contractors – sales, business development, research and development (R&D), software development, services, customer support
2. The risks incurred – R&D, product development, long-term contracts, supply chain, market

risks, credit and bad debt risks, foreign exchange risks

3. Functions performed by one legal entity for another – fundraising, provision of loans, strategic directives, administrative services, customer referrals, lists
4. The intangible and tangible assets deployed – technology, know-how, trademarks and trade names, corporate reputation, inventory, warehouse goods, real property assets, leaseholds
5. The competitive landscape and how one's business is similar or different from competitors.

For SMEs that are micro-multinationals, painting the 'business picture' is the first step in the transfer pricing exercise. This process will become a 'rite of passage' into the global game where tax authorities stake out their claim and exert their taxing rights over multinational companies in order to properly divide the global tax 'pie'.

If you have any questions or would like to discuss this article further, please contact:

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