

Transfer pricing considerations of the euro crash

An idea worth considering | July 20, 2010

Undoubtedly you've noted the rapid devaluation of the euro relative to the U.S. dollar, but what does that mean for your business?

If you are a multinational enterprise who engages in controlled, intercompany SSSLL transactions (sales, services, leasing, loans and licensing), you need to proactively address transfer pricing issues.

Example

Suppose a USD (U.S. distributor) buys inventory from EM (Euro Manufacturer), in a controlled intercompany transaction. Assume also (unrealistically, but let's keep the math simple) that (1) in Month One, the USD-euro exchange rate is 1:1; but (2) in Month Two, the Euro deflates to a 1:2 exchange rate (one USD buys two euros).

Obviously, USD can buy euro-sourced inventory in Month Two for substantially less than in Month One. Suppose further that generally there is a lag period in the

supply chain, specifically, between ordering and the production cycle. Numerous different questions should, and in intercompany transactions, do arise.

Questions to consider

- Whom between USD and EM should (or must) bear the currency risk in the supply chain?
- Should either company hedge, or at arm's length, should they have hedged? And if so, under what terms and conditions?
- What if USD had sent an advance payment to EM? Or, may USD delay payment?
- What if EM is a contract manufacturer? Should it bear any currency risk? Why or why not?
- May USD simply wait to pay for the inventory in Month Two (or beyond), or for tax-planning purposes, should it (or may it)?
- What planning opportunities are available to proactively account for currency risk?



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- How would the respective U.S. and European governments view an intercompany arrangement where one company, but not the other, bears all of the currency risks?

The general rule of transfer pricing says that controlled transactions must achieve arm's-length results. But what arm's-length results would, should and could occur in transactions where currency fluctuations are present? What answers (i.e., tax positions) are acceptable to different taxing jurisdictions? Or conversely, what tax positions relating to currency risks are "uncertain" — and are disclosures necessary?

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