

Manufacturer

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Take care with transfer pricing

Out-of-compliance policies can lead to costly tax penalties

Before you sell equipment or patent rights to a company affiliate, think twice about the price. With revenue-hungry governments worldwide looking to keep their tax bases strong, many are stepping up enforcement on transfer pricing.

Manufacturers that don't follow the rules can be taxed twice on transactions, and face hefty penalties to boot. If your company has multiple entities that buy and sell from one another, now is the time to review your transfer pricing policies.

What is transfer pricing?

"Transfer pricing" refers to the price that related parties, such as divisions of a company, charge one another for goods or services. These include tangible goods, services, intangible property, interest on loans and other financial transactions.

Transfer pricing piques the interest of tax authorities because it affects the amount of taxable profits for each division of a company. Because taxes vary from country to country, a company theoretically could slash its tax burden by transferring income to another division in a lower tax bracket. A U.S.

dress manufacturer, for example, could buy dresses from its plant in Malaysia, where taxes are lower, at artificially high prices to reduce its taxable income in the United States. Transfer pricing laws prohibit these transactions from occurring to ensure that each country gets its fair share of tax revenue.

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Most countries have the authority to adjust the price of transactions between companies in their jurisdictions and foreign entities. This makes transfer pricing a hot issue for multinational manufacturers. Even manufacturers whose operations are within U.S. borders need to handle transfer pricing carefully, though, because the United States can adjust prices between domestic related parties.

Is the transaction at "arm's length"?

Countries generally require transactions between related parties to meet an "arm's-length" standard, which means the price is comparable to what it would have been if the parties weren't related. When comparing pricing for a transaction to similar transactions between unrelated parties, consider all applicable conditions, including the geographic market, related warranties and other terms of sale. Because comparable transactions can be difficult to find, particularly for intellectual property or other intangible goods, the resulting arm's-length standard often is a range of prices, rather than a specific price.

There are several methods to test whether prices meet an arm's-length standard. The United States



and the Organisation for Economic Co-operation and Development, a Paris-based organization of 34 countries that issues global transfer pricing guidelines, require companies to use the method that produces the most reliable results. This means that companies may have to use more than one test to determine the correct pricing. In addition to transactional methods, companies can use profitability methods, which base appropriate pricing on the profit levels of similar companies in similar industries.

A growing number of countries, including the United States, China, India and Italy, require companies to prepare transfer pricing studies that show the basis behind their pricing. And after manufacturers prepare their studies, they need to stick to them — tax authorities will penalize companies whose actual pricing for transactions differs substantially from the pricing included in their studies.

Is an audit in your future?

Even if your company follows all transfer pricing rules, you may still be subject to an audit of your transfer pricing practices. Common audit triggers include a lack of documentation; large transactions; royalties or payments for intangible goods; operating losses, particularly multiyear losses; large year-to-year shifts in the level of profits or losses; transactions with related parties in low-tax countries; and a low effective tax rate compared with gross revenue.

The key to surviving an audit is having the appropriate transfer pricing documentation in place before the authorities come knocking. A transfer price study is one of the first things the IRS asks for during the audit, and while it takes several months to complete one correctly, the IRS typically wants it in 30 days.

If a government decides that the price you charged or paid to a related party was inappropriate, it will adjust the price and tax you on the difference — meaning you pay tax on income that your related party already paid tax on as well. Manufacturers that don't have required

Is an advance pricing agreement right for you?

With stepped-up scrutiny on transfer pricing, many manufacturers are minimizing their risk by entering into advance pricing agreements (APAs). These agreements, entered into by tax authorities and companies, set agreed-upon prices for related-party transactions, virtually eliminating the risk of documentation-related penalties or double taxation. Manufacturers also can resolve pending pricing disputes by instituting an APA, which can be applied retroactively to pricing from previous years.

An APA most often is multilateral — that is, it covers your dealings with the IRS as well as the tax authorities in the other countries where you do business. The agreements typically are valid for several years.

Creating an APA can be time-consuming and expensive. Is it worth your time and trouble to negotiate an APA? The answer may be yes if:

- You're involved in complicated or unusual related-party transactions,
- You regularly complete related-party transactions of intellectual property or other intangible goods,
- You use uncommon methods for determining "arm's-length" pricing,
- You're already being audited for transfer pricing, or
- You're risk-averse.

transfer pricing studies in place also are subject to penalties, which can be as much as 40% of the additional tax assessed in the United States.

Play by the rules

If your company has multiple entities that buy and sell from one another, review your transfer pricing policies to ensure they're in compliance. If you're on the right side of transfer pricing laws, you'll avoid having your profits gobbled up by audit costs and penalties. ■

Reaping the benefits of an employee retirement plan

Your manufacturing company doesn't offer a retirement savings plan for your employees? Join the club. About half of working Americans don't have a retirement plan at work, according to the IRS.

The IRS is working to change that statistic with several recent initiatives to encourage participation among employers and employees. For manufacturers, establishing a retirement plan makes your company more attractive to potential hires and translates into tax benefits. If you don't have a plan in place, here's how to get started.

Two categories of plans

Retirement plans generally fall into one of two categories: defined-benefit plans, where employees receive a fixed amount when they retire, and defined-contribution plans, where employees contribute a fixed amount to an account during their careers. Defined-contribution plans are more common these days in the private sector, and the 401(k) plan is the most popular among them. When implementing a 401(k) plan, you can choose whether to match your employees' contributions.

Whatever plan you choose, your contributions and your employees' contributions are tax-deductible.

Choosing an automatic enrollment 401(k) plan can increase employee participation further. And the IRS no longer requires employers to



apply for approval before instituting automatic enrollment. Under these plans, employees automatically have a portion of their paychecks deposited into a retirement account, and can opt out of the plan at any time.

Another recent IRS initiative allows companies to automatically increase the amount of an employee's paycheck that is diverted to a savings plan each year. Employees may stop the increases at any time.

As for defined-benefit plans, you can offer pension plans, which pay employees a fixed amount periodically after they retire, or a new alternative — the cash balance plan, which sets an employee's retirement account at a particular level, such as \$100,000, when the employee retires. The amount of benefits in an employee's cash balance plan is specified in the plan's terms and typically is based on the employee's salary and a fixed or variable

interest level. On retirement, the employee can take the account balance in a lump sum or as monthly payments.

Whatever plan you choose, your contributions and your employees' contributions are tax-deductible. Qualified manufacturers also can claim tax credits of up to \$500 a year for the plan's first three years to cover start-up and maintenance costs.

Maintain your plan

After your plan is in place, monitor it to ensure it retains its preferential tax status and to avoid errors. You'll need to file paperwork with the IRS each year showing that your plan doesn't favor certain workers over others, that plan costs are reasonable and that plans operate in participants' best interests. If your plan loses a large number

of participants because of employee turnover or layoffs, you may incur a partial plan termination and lose your plan's tax-favored status. Make sure you know the effect on your plan before instituting major personnel changes.

If you discover errors in your plan, the IRS offers several options for correcting them. Depending on the severity of the error, you may pay a fee, but resolving the issue will help you avoid having your plan terminated.

Many options

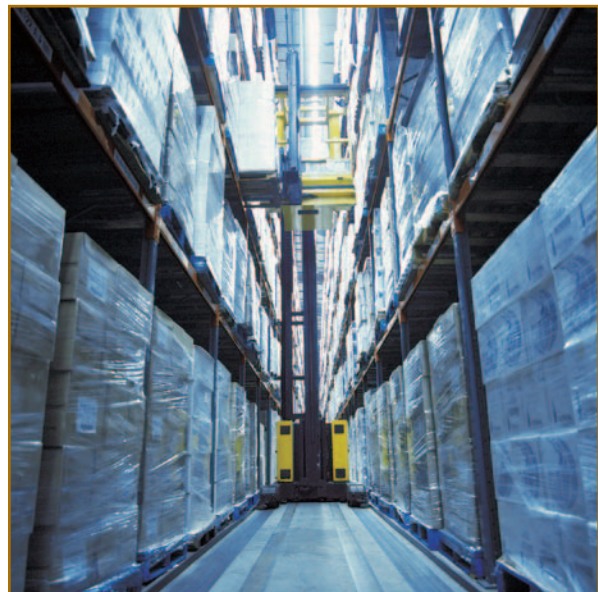
You want to retain your best employees and attract highly qualified new candidates. Offering an employee retirement plan can help. There are many different plan types to choose from, so discuss with your financial advisor which makes the most sense for your company. ■

Are you ready to streamline your warehouse?

Increased efficiency and productivity are music to any distributor's ears, and you can achieve both with one solution: a warehouse management system (WMS). Bear in mind, however, that successfully installing a WMS requires extensive planning and a fair amount of financial resources.

Implementing and investing

Implementing a WMS can enhance inventory flow management and transaction processing by easing inventory stocking, picking and replenishing activities. Depending on the type of functions offered with the software selected, a WMS can also facilitate a variety of important warehousing activities, such as automated data collection and material handling.



Use BMS to get the most out of your WMS

A warehouse management system (WMS) can help streamline your distribution operations, but do you know how to maximize its return on investment? If not, a business management system (BMS) may be the answer. BMS entails integrating, aligning, standardizing, streamlining and automating business processes and supporting information technology systems for optimum performance and efficiency.

BMS can be particularly useful for distributors. It can unify processes, bring about discipline — among a company's employees, and to its relationships and interactions with suppliers and customers — and support IT systems, such as WMS, to achieve strategic goals.



But is investing in a WMS the right decision for every distributor? Honestly, no. As with similar undertakings, you must carefully weigh the costs vs. the benefits because, like other distributors, you may be unable to justify the initial, often sizable, investment.

Plus, you can't just plug in a WMS and expect it to run on its own. Setting up and operating this application is often a complex process. You'll need to dedicate resources to manage the data-intensive system — your WMS may even warrant its own staff.

Classifying inventory data

When comparing the costs and benefits, keep in mind that implementing a WMS involves classifying inventory data by physical characteristics. You might need to capture and maintain inventory item details including size dimensions, weight, how the item is stocked, stacking height, hazard precautions, and movement rate.

As you evaluate whether a WMS is right for your business, also consider how easily it will integrate with your other accounting or resource planning systems.

Other necessary data includes order sequence logic for directing stocking, picking and replenishing activities. You can even base order sequence for these activities on either the first-in, first-out or last-in, first-out inventory accounting method. Of course, you'll want to adjust the specified logic based on workload changes and busy seasons. Subsequently, the more diverse the product mix, the more complex the WMS setup and implementation process.

Considering compatibility issues

As you evaluate whether a WMS is right for your business, also consider how easily it will integrate with your other accounting or resource planning systems, and whether it can support other types of warehouse functions.

For instance, you may want to execute automated data collection using radio-frequency identification technology, or you may have automated material handling equipment (such as automatic guided vehicles or pick-to-light systems) to factor into your decision. In any case, you'll likely need to do some programming to

integrate other systems and equipment, so be sure to plan for these costs.

When implementing a WMS, thoroughly test the new application. It's better to discover any kinks during a trial run than during a client transaction. Moreover, your system will be only as useful as your staff using it, so take the time to train workers well.

Don't make an impulse decision

Before making a final decision on whether to implement a WMS, it's important to review all facets of your distributorship. A WMS can be complex and costly to implement, so task your management team with determining exactly how they'll use it and how it will integrate with your other systems. ■

Strategies for shrinking your conveyor's lifetime cost

A conveyor is one of the most vital pieces of manufacturing equipment — and one of the most expensive. Understand the total cost of your conveyor, and you'll get the biggest bang for your buck.

Your conveyor's cost goes well beyond its initial price tag, because installation, maintenance and energy usage also chip away at your bottom line. Buying a conveyor that meets your needs and maintaining it properly can extend the system's life and save you money.

When you shop for a new conveyor, consider your facility's configuration and throughput requirements. Investing more in certain features, such as a decentralized drive or an energy-efficient power train, may pay off through increased productivity and reduced operational costs. You'll also want to consider the system's flexibility. Conveyors that you can adapt to different-size loads without hiring outside help can slash your costs.

After you buy a system, configure the controls to save even more. Use your conveyor's sleep feature during down times to cut electricity use, and ramp down your conveyor's speed when possible to save electricity and reduce costly wear and tear.

Current tax deductions can shave additional dollars off your conveyor's cost. Under the Tax Relief Act of 2010, you can deduct 100% of the cost of equipment purchased in 2011, instead of deducting it over the equipment's lifetime. Qualified purchases include new equipment with a lifespan of less than 20 years.

For equipment purchased in 2012, you can deduct 50% of the equipment's cost. Manufacturers that operate as corporations can accelerate their alternative minimum tax credits instead of claiming bonus depreciation for their conveyor purchases. If your total annual equipment spending is less than \$500,000, you also can use Section 179 expensing rules to deduct up to \$125,000 of your conveyor's cost from your 2012 taxes.



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