WHITE PAPER

Navigating Transfer Pricing for Japanese Automotive Companies

Best Practices & Insights

By: Kevin Griffin

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JACO ADVISORY GROUP

Business Advisory Services

The international automotive market continues to be a dynamic and hypercompetitive industry. Global automotive OEMs and their vast supply chains continue to expand their operations to serve new markets and develop supply chains in low-cost regions while working to de-risk these complex supply chains.

Over the last 25+ years, Japanese car manufacturers such as Toyota, Honda, Nissan, and Mazda, have significantly increased their operations in North America to support their strategy of producing vehicles where they sell them. Navigating their international expansion comes with various challenges, including the formulation of an effective transfer pricing strategy.

This white paper investigates transfer pricing for Japanese automotive companies operating in the U.S. and provides insights for implementing practical and compliant strategies that minimize potential tax liabilities while maximizing profitability.

6605 Longshore Street | Suite 240 | Dublin, OH 43017

P: 866.799.9003 | E: info@jacoadvisorygroup.com

www.jacoadvisorygroup.com |

Overview of Transfer Pricing

Transfer pricing refers to the prices of goods and services exchanged between companies under common control within a multinational organization when operating in multiple jurisdictions. These prices determine the profits made by each entity and are consequently critical for the calculation of local taxes.

Legal Regulations in Japan & the United States

An effective transfer pricing strategy must comply with the regulations set by the fiscal authorities in both Japan and the United States. In the U.S., transfer pricing rules are governed by Sections 482 and 6662 of the Internal Revenue Code (IRC). Japanese transfer pricing guidelines are set forth by the Ministry of Finance (MOF) following the Authorized OECD Approach (AOA), which aligns Japanese regulations closely with those of the United States.

Both countries require multinational corporations to establish arm's length pricing, which refers to the conditions that unrelated parties would have agreed upon in comparable transactions. Japanese and U.S. policymakers have also signed a bilateral Advance Pricing Agreement (APA) program, which facilitates coordinated review and resolution of transfer pricing disputes.

Valuation Methods for Transfer Pricing

Both Japanese and U.S. authorities permit the use of three primary methods for determining arm's length pricing:

1. **Comparable Uncontrolled Price (CUP) Method**. This approach compares the price charged for a good or service in a controlled transaction between related parties to that of a similar uncontrolled transaction between independent parties.
2. **Resale Price Method (RPM)**. This method begins with the selling price of a product to an unrelated party, then subtracts a gross margin based on comparables, which results in an arm's length price for an upstream transaction.
3. **Cost Plus Method (CPM)**. This approach entails building an arm's length price by adding a markup to the cost of producing a good or providing a service. The markup is derived from comparable transactions involving independent parties.

Factors Affecting Transfer Pricing for Automotive Companies

Transfer pricing for Japanese automotive companies in the U.S. is impacted by a variety of factors, including:

1. **Manufacturing and Production Costs**. Variations in labor costs, energy prices, and logistics expenses will influence the transfer pricing of goods produced in Japan and sold in the U.S. market.
2. **Intellectual Property**. With advancements in technology and increasing automation, royalties and license fees for intellectual property rights must be considered when determining transfer pricing for cross-border transactions.
3. **Market Fluctuations**. Exchange rate fluctuations and economic variations in both countries will inevitably impact transfer pricing for associated enterprises.

Best Practices for Transfer Pricing Strategies in the Automotive Industry

1. **Maintain Comprehensive Documentation**. To mitigate potential disputes and tax penalties, Japanese automotive companies should maintain detailed transfer pricing documentation that follows regulations in both the United States and Japan.
2. **Conduct Benchmark Studies**. Regularly conducting comparability analysis and benchmarking the prices and margins within the industry can ensure that transfer pricing remains within the arm's length range and is compliant with regulators.
3. **Implement Advanced Pricing Agreements (APAs)**. Pursuing bilateral or multilateral APAs with tax authorities can offer increased certainty and reduced risk of transfer pricing disputes.

Conclusion

Having a transfer pricing strategy is a critical component of international tax strategy for Japanese automotive companies with operations in the United States. By understanding the regulatory landscape, maintaining rigorous documentation, and proactively managing risks, these companies can effectively navigate complex transfer pricing challenges while maximizing their global competitiveness and profitability.

About Kevin

Kevin Griffin is an experienced executive with over 40 years of senior financial management experience. He has worked in both public and privately held businesses as well as regulated industries. He has an in-depth background in SEC reporting, regulatory compliance, treasury and cash management, credit relationships, global tax reporting and compliance, risk management, and company equity and retirement plans.

In addition to his technical background, Kevin has extensive experience in strategic planning, due diligence, mergers and acquisitions, divestitures and dissolutions, capital formation, and business valuations. His experience spans multiple industries - public accounting, manufacturing, financial services, and insurance - in both high-growth and turnaround operations.

His problem-solving ability is aided by a well-developed quality to create solutions by listening to and asking probing questions of, the various stakeholders of a business.

Kevin is a Certified Public Accountant (CPA) and in addition to serving in his corporate roles, he has also served in interim and transitional management C-level executive positions, such as Chief Financial Officer and Chief Restructuring Officer on a consulting basis.

Kevin holds a Bachelor of Science in Accounting from Central Michigan University. He is a member of the American Institute of Certified Public Accountants, and the Michigan Association of Certified Public Accountants.