Tricks of the corporate trade

Dr. Commerce, I keep hearing about something called transfer pricing. Can you explain what it is?

Of course. Transfer pricing is when companies shift income out of the United States to its foreign subsidiaries, keeping profits away from the Internal Revenue Service. Though transfer pricing is usually associated with tax evasion, it can also be used to launder money.

A study released last week, co-authored by Florida International University finance professor John Zdanowicz, showed that U.S. corporations used transfer pricing to avoid paying $53 billion in taxes last year, up from $35.7 billion in 1998.

Under transfer pricing, a U.S. company buys something at an inflated price from one of its foreign subsidiaries, thereby keeping the money in the company while reducing the company’s tax burden in the United States. On the other hand, a manufacturer can write off losses from selling a product overseas at an undervalued price, even though the profits are held by the foreign partner.

Some examples: The study cited overvalued imports including cotton dish towels from Pakistan at $153 each, tweezers from Japan at $4,896 a unit and plastic buckets from the Czech Republic at $973 each. Undervalued exports included missile launchers sold to Israel for $52 a unit, clinical thermometers sold to Germany for 6 cents each, and bus and truck radial tires sold to Britain for $11.74 each.

The $53 billion in lost taxes is actually more, the authors indicated, because the study analyzed only commodities that could be measured in quantities. If non-quantifiable goods were considered, the “tax loss would be significantly higher,” the study said.

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