Court Rules for Company in Tax Case, Finds IRS Transfer Pricing Claim “Flawed”

Press Releases

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The domestic subsidiary of a Hong Kong-based furniture maker recently won a decision disallowing a U.S. Internal Revenue Service (IRS) tax claim of nearly $13 million because the Court determined the IRS used a “flawed” transfer pricing analysis.

The ruling in the Chapter 11 bankruptcy case *In Re: DeCoro USA, Limited* (Case No. 09-10846C-11G, U.S. Bankruptcy Court for the Middle District of North Carolina) centers on transfer pricing, a profit allocation method used to attribute a multinational corporation’s net profit or loss to countries where it does business. The IRS has designated transfer pricing as a key focus of its international compliance initiatives, and sought to show that the Debtor underreported its income in order to avoid paying taxes.

But attorneys from the Bankruptcy Practice at Archer P.C. in Haddonfield, N.J., representing the Trustee for the Debtor, defeated the IRS claim by demonstrating to the Court that the IRS transfer pricing adjustment “was based upon a flawed analysis that did not comply with the IRS’s own regulations and was thus unreasonable,” the Hon. William Stocks, Judge of the U.S. Bankruptcy Court, wrote in his opinion.

The Debtor is a wholly owned, U.S. subsidiary of a Hong Kong parent company, DeCoro Limited, that engaged in sales of furniture to customers in the United States. Both companies declared bankruptcy, the domestic subsidiary through a Chapter 11 filing and the Hong Kong parent via Chapter 15.

The IRS claims the Debtor has tax deficiencies due to its taxable income being underreported from 2004 to 2007. The IRS bases its claim on its contention that the U.S. subsidiary functioned as an independent distributor of the Hong Kong parent company, and therefore, under section 482 of the Tax Code, the subsidiary’s income should be adjusted upward to be comparable with similar, independent distributors.

At trial, however, Archer attorneys successfully argued that the IRS erred in classifying the Debtor as an independent distributor of the parent company, rather than in accordance with the subsidiary’s actual role as a mere facilitator or dependent agent. The Archer team, led by Bankruptcy Practice Chair Stephen M. Packman, presented evidence that the Debtor company’s functions were so limited and its risks so minimized that a comparison with comparable businesses showed that the Debtor was consistently within the range of arm's length transactions. Mr. Packman's team refuted conclusions of the IRS expert and showed that he "failed to examine and consider the true substance" of the business relationship and transactions between the parent and the U.S. subsidiary. In his well-reasoned opinion, Judge Stocks undertakes a thorough analysis of the facts and sets forth the factors that led him to reject the IRS's argument that the U.S. subsidiary was an independent distributor.

The IRS has appealed the ruling, which has drawn considerable interest due to its ramifications for the declared crackdown on transfer mispricing.

The Bankruptcy Practice at Archer P.C. is consistently ranked among the region's finest by legal industry rating services such as Chambers USA. Mr. Packman, who also serves as co-Chair of the firm's International Law Group, is Board-certified in business bankruptcy law by the American Board of Certification, and is an inaugural Fellow of INSOL, the international association of restructuring professionals. The firm has represented hundreds of companies, committees, trustees, lenders, creditors and other parties in reorganizations and liquidations (both in and outside of bankruptcy), and in connection with other debtor and creditor matters such as foreclosures, litigation and workouts. Mr. Packman and the Bankruptcy Practice handle cases regionally, throughout the U.S., and internationally, including considerable experience representing parties in cross-border matters such as Chapter 15 bankruptcy proceedings.

Archer PC is a full-service regional law firm with more than 175 lawyers and nine offices in Haddonfield, Hackensack, Princeton, Flemington and Red Bank N.J.; Philadelphia, Pa.; New York, N.Y.; and Wilmington and Georgetown, Del. The Firm has been serving Fortune 100 clients, small to medium-sized businesses and individuals for 85 years. Each office provides full-service litigation and transactional capabilities in nearly every area of law including corporate, estate & trust, family & matrimonial, labor & employment, litigation, medical & personal injury and real estate services. For more information, visit www.archerlaw.com.

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