Case 12-2

Global Electronics Company

Global Electronics Company (GEC), a U.S. taxpayer, manufactures laser guitars in its Malaysian operation (LG-Malay) at a production cost of $120 per unit. LG-Malay guitars are sold to two customers in the United States—Electronic Superstores (a GEC wholly owned subsidiary) and Walmart (an unaffiliated customer). The cost to transport the guitars to the United States is $15 per unit and is paid by LG-Malay. Other Malaysian manufacturers of laser guitars sell to customers in the United States at a markup on total cost (production plus transportation) of 40 percent. LG-Malay sells guitars to Walmart at a landed price of $180 per unit (LG-Malay pays transportation costs). Walmart pays applicable U.S. import duties of 20 percent on its purchases of laser guitars. Electronic Superstores also pays import duties on its purchases from LG-Malay. Consistent with industry practice, Walmart places a 50 percent markup on laser guitars and sells them at a retail price of $324 per unit. Electronic Superstores sells LG-Malay guitars at a retail price of $333 per unit.

LG-Malay is a Malaysian taxpayer and Electronic Superstores is a U.S. taxpayer. Assume the following tax rates apply:

U.S. ad valorem import duty	20%
U.S. corporate income tax rate	35%
Malaysian income tax rate	15%
Malaysian withholding tax rate	30%

1) a) 180 - Comp uncontrolled
b) 189 - Cost plus
c) 185 - Resale

Required

1. Determine three possible prices for the sale of laser guitars from LG-Malay to Electronic Superstores that comply with U.S. tax regulations under (*a*) the comparable uncontrolled price method, (*b*) the resale price method, and (*c*) the cost-plus method. Assume that none of the three methods is clearly the best method and that GEC would be able to justify any of the three prices for both U.S. and Malaysian tax purposes.

how did they get computed

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2. Assume that LG-Malay's profits are *not* repatriated back to GEC in the United States as a dividend. Determine which of the three possible transfer prices maximizes GEC's consolidated after-tax net income. Show your calculation of consolidated net income for all three prices. You can assume that Electronic Superstores distributes 100 percent of its income to GEC as a dividend. However, there is a 100 percent exclusion for dividends received from a domestic subsidiary, so GEC will not pay additional taxes on dividends received from Electronic Superstores. Only Electronic Superstores pays taxes on the income it earns.

- w/h tax
- US tax on LG Malay Dividend

3. Assume that LG-Malay's profits *are* repatriated back to GEC in the United States as a dividend and that Electronic Superstores profits are paid to GEC as a dividend. Determine which of the three possible transfer prices maximizes net after-tax cash flow to GEC. Remember that dividends repatriated back to the United States are taxable in the United States and that an indirect foreign tax credit will be allowed by the U.S. government for taxes deemed to have been