armanino

TAX CLIENT SUCCESS STORY

M&A TRANSFER PRICING ANALYSIS FOR INDIAN SUBSIDIARY FREES $700K IN ESCROW

Challenge
During M&A due diligence, the buyer of a software company withheld $1.25M in escrow for potential tax exposure from lack of transfer pricing documentation in an Indian subsidiary.

Solution
Our experts prepared seven years of transfer pricing documentation, analyzed the tax calculations to defend the company's position and helped negotiate down the escrow amount.

Result
The company reduced its tax exposure from $1.25M to $552K, and the buyers released nearly $700K from escrow.

CLIENT CHALLENGE

A software company offered a productivity enablement and workflow platform that empowered their clients to manage work within all departments and across multiple offices. It had a subsidiary in India, incorporated in 2006, that provided bookkeeping and accounting services for U.S. clients and prepared and processed U.S. tax returns for individuals, corporates, partnerships and trusts, earning a cost-plus markup of 15% for the intercompany services.

The company was acquired in 2020. While completing due diligence, the buyers identified a potential Indian tax liability in exposures and penalties because the subsidiary did not prepare contemporaneous Indian transfer pricing documentation. As a result, the buyers withheld $1.25M in escrow for the tax liabilities.

THE TAX ISSUE

Historically, the Indian subsidiary did not prepare the transfer pricing documentation. The subsidiary also had large outstanding intercompany balances, which was another area of focus by the Indian tax authorities.

The buyer's due diligence team originally calculated tax and penalty exposure of $1.25M for the noncompliance in maintaining a transfer pricing documentation, targeting a markup of 25% for software development and 18% for IT support activities, goods and services tax (GST) for free use of the software provided by the U.S. parent company to the subsidiary, intercompany advances and other related issues.

OUR SOLUTION

The seller engaged Armanino to help defend their Indian transfer pricing policy, prepare Indian transfer pricing documentation and negotiate the release of the funds held in escrow. Our experts assisted in the preparation of seven years of transfer pricing documentation and reviewed the exposure calculations shared by the company's tax advisors.

We identified numerous errors and areas where penalties were overly assessed, and we prepared robust economic analyses to support the cost-plus 15% markup. We also negotiated with the buyer's tax advisors to dismiss the advancement of service issues and the GST on free use of software by the subsidiary.

THE RESULT

The software company was able to prove to the buyer that the 15% markup was arm's length and no adjustments were warranted for:

- The higher markup proposed by the buyer's due diligence team
- GST for the free use of software
- The advancement of services issues

The tax exposure was reduced from $1.25M to $552K, and the buyer released the remaining $700K from escrow.

OUR EXPERT

Nghi Huynh
Partner-in-Charge, Armanino Advisory LLC
Nghi.Huynh@armanino.com
408 200 6429