Vik-Giger Corpotation

Multinational transfer pricing and taxation.

Vik-Giger Corporation, headquartered in the U.S., manufactures state-of-the-art milling machines. It has two marketing subsidiaries, one in Brazil and one in Switzerland, that sell its products. Vik-Giger is considering building one new machine, at a cost of $500,000. There is no market for the equipment in the United States. The equipment can be sold in Brazil for $1,000,000, but the Brazilian subsidiary would incur transportation and modification costs of $200,000. Alternatively, the equipment can be sold in Switzerland for $950,000, but the Swill subsidiary would incur transportation and modification costs of $250,000. The U.S. company can sell the equipment either to its Brazilian subsidiary or to its Swiss subsidiary but not to both. Vik-Giger Corporation and its subsidiaries operate in a very decentralized manner. Managers in each company have considerable autonomy, with each division manager interested in maximizing his or her own division's income.

Questions:

1. From the viewpoint of Vik-Giger and its subsidiaries taken together, should Vik-Giger Corporation manufacture the equipment?
    - If it does, where should it sell the equipment to maximize corporate operating income?
    - What would the operating income for Vik-Giger and its subsidiaries be from the sale? Ignore any income tax effects.
2. What range of transfer prices will result in achieving the actions deter- mined to be optimal in requirement 1? Explain your answer.
3. The effective income tax rates for this transaction follow: 40% in the United States, 60% in Brazil, and 15% in Switzerland. The tax authorities in the three countries are uncertain about the cost of the intermediate product and will allow any transfer price between $500,000 and $700,000. If Vik-Giger and its subsidiaries want to maximize after-tax operating income:
    - (a) should the equipment be manufactured and
    - (b) where and at what price should it be transferred?
4. Now suppose each manager acts autonomously to maximize his or her own subsidiary's after-tax operating income. The tax authorities will allow transfer prices only between $500,000 and $700,000. Which subsidiary will get the product and at what price? Is your answer the same as your answer in 3? Explain why or why not.