Vik-Giger Corpotation

Multinational transfer pricing and taxation.

US subsidiary

- 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.

Brazilian subsidiary

- The equipment can be sold in Brazil for $1,000,000, but the Brazilian subsidiary would incur transportation and modification costs of $200,000.

Swiss subsidiary

- Alternatively, the equipment can be sold in Switzerland for $950,000, but the Swiss subsidiary would incur transportation and modification costs of $250,000.

Decision

- 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.

Question 1:

- From the viewpoint of Vik-Giger and its subsidiaries taken together, should Vik-Giger Corporation manufacture the equipment?
  - (a) If it does, where should it sell the equipment to maximize corporate operating income?
  - (b) What would the operating income for Vik-Giger and its subsidiaries be from the sale? Ignore any income tax effects.

Question 2:

- What range of transfer prices will result in achieving the actions determined to be optimal in requirement 1? Explain your answer.

Question 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?

Question 4:

- Now suppose each manager acts autonomously to maximize his or her own subsidiary's after-tax operating income, and the subsidiaries are given the freedom to negotiate their own transfer price.
  - 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.