



Munich Personal RePEc Archive

## **The Effects of Transfer into Fiscality Prices**

Ciumag, Marin

Universitatea "Titu Maiorescu" Bucuresti

26 May 2006

Online at <https://mpra.ub.uni-muenchen.de/14959/>

MPRA Paper No. 14959, posted 02 May 2009 16:12 UTC

## THE EFFECTS OF TRANSFER INTO FISCALITY PRICES

The notion of "transfer prices" comes from The United States of America (XIX - XX century) representing an equitable part of the tax. This notion was developed because of different taxation, meaning that the states were perceiving taxes established at a local level (different in their quantum from state to state) and the federal state was perceiving the established unique tax.

The railway companies were the first that have entered in contact with the transfer prices, namely:

- They were paying the federal tax from the incomes realised on the territory of different states;
- They were paying taxes owed to the states, differentiated according to the number of stations that they had inside the states.

The problem appeared was that on the territory of Arizona State there is not any Railway station of the respective companies; this state is not receiving any tax for the Railway transit. Subsequently there was settled the so called "transfer price", so that each state to receive the tax afferent to the realised profit on each territory.

It is estimated that over 60% of world commerce it's unrolling through the multinational societies, which means a turnover with many zeros, and the afferent taxes reach impressive sums.

This is why the states on which the multinationals are unrolling their activity are very preoccupied in taking their "cake slice" (the tax) that is proper for them. In fact the problem does not refer only at multinationals; generally, are taken into consideration the transaction unrolled between the affiliated persons as they are defined by the law (the Fiscal code).

The attention given to such transactions is owed to the so called practice "price transfer". Therefore with a view to optimizing the duties and the taxes but also to reach the economical objectives, the companies from a group are wont to make some transactions, at special prices and/or in special conditions, among them. The special prices/conditions determine the distortion of tax basis and consequently the alteration of the owed duties and taxes.

From this point of view "the special transactions" will be reconsidered from fiscal point of view in order to determine with a precise exactness the duties and taxes that must be for each fiscal jurisdiction (each state) suppose that these would be performed in free market conditions.

It won't be made reconsiderations of the transactions when these are unrolled among affiliated Romanian legal persons, according to legal forecast.

With a view to analyzing the risks of taxing matter transfer towards a country with a light fiscal system, there will be taken into consideration, during fiscal inspections, at least the following:

- The payment of some profits for fictive debts;
- The finance through hiding the affiliation connections (usually by a society of foreign credit);
- The payment of royalties for its right to use licences or marks towards a company situated in a fiscal paradise;
- The hiring by external leasing of fixed means necessary for production, at higher values than those practiced among independent legal persons. By this operation the profit is transferred under the shape of financial expenditures, superior to those of the acquisition of fixed means.

The fiscal authorities from România can, in order to calculate the affiliated person's fiscal obligations, reconsider the evidences of the affiliated person from România, in order to fiscal examination, if as a result of special relations among the Romanian affiliated person and the foreign one these evidences are not reflecting the real taxable profits that come from România. The reconsideration of the evidences is referring to the adjustment of incomes, expenditures as well as of other elements similar to the incomes and expenditures in order to calculate fiscal obligations of the affiliated persons.

In case of the existence of some conventions of avoiding the double assessment with the residency state of the foreign affiliated person, this reconsideration of the evidences in order to

fiscal examination is effectuated by Romanian authorities in collaboration with "the Friendly Procedure" provided in the respective convention. The profits adjustment must be made so that it also is liked by the state that has made the initial assessment in accordance with the situation existent at the moment of the assessment establishment.

In establishing the market value of the transactions, the fiscal authority won't take into consideration the effective circumstances that cannot be known by parts of the transaction, at the moment of the transaction conclusion and that, if they were known, they would attract an over or under estimation of transaction value by the parts involved.

In the case of establishing by the contributors of the market value of the transactions on the basis of one of the known methods and in the case in which the veracity and objectivity of the details are not arousing justified queries, the authorities will establish the market value of those transactions by applying the previous used method by the contributor, except for the cases in which is obviously more indicate the application of a different method, in accordance with the legal forecasts or the detail of which disposes.

In order to estimation the market value it can be used the following methods, by whom it can be don the reconsideration of transactions: The method of prices comparison;

- The method cost-plus;
- The method of resale price;
- The method of sharing the profit.

The above mentioned methods have at their back extremely complex working procedures that ask for best quality experts and information sources.

In essence all the methods are proposing the same thing - to determine the correct price of a transaction about which there is the suspicion that is unrolled in special conditions and/or prices. In the same way will be determined the correct profit that an affiliated person would have obtained it, if the transaction would unrolled in free market conditions, and the tax afferent to this one.

The reconsideration of a transaction will take into consideration the following elements:

- The opportunity (if such a transaction would have been realised in free market conditions);
- The independence (if the transaction price was at the level of the one of the free market).

### **The method of price comparison**

Has at its basis the comparison of analysed transaction price with the prices practiced by entities independent of this one, when there are sold comparable products or services.

For goods, products, merchandises or services transfer among affiliated persons, the market value is that price that would have been agreed by independent persons, in the existent conditions on comparable markets from commercial points of view, for identical or similar goods or merchandises, in comparable quantities, in the same point of production and distribution chain and in comparable conditions of delivery and payment. In this purpose in order to establish the payment value it can resort to:

- The comparison of agreed prices among affiliated persons with the prices agreed in the relations with other independent persons, for comparable transactions (the internal comparison of the prices);
- The comparison of the agreed prices among independent persons for comparable transactions (the external comparison of prices);
- Uncontrolled transaction is comparable with a controlled transaction, if:
  - neither of the differences among transactions that are compared or among persons that unroll this transactions cannot substantially affect the price in a free market; or if
  - it cannot be made sufficiently precise adjustments for the elimination of the effects of any difference from the above mentioned ones.

### **The method cost-plus**

In order to determine the regular price of the market, the method is relying upon the increase of main costs with an profit rate similar to the contributor's field of activity. The outset is represented by the producer's or the supplier's costs.

There where the merchandises or the services are transferred by a number of affiliated persons, this method follows to be applied separately for each stage, taking into consideration the role and the concrete activity of each affiliated person.

### **The method of resale price**

The market price is determined on the basis of the resale price of products and services towards independent entities, decreased by commercialization expenditures and a profit rate.

This method is applied starting from the price that a bought product by an affiliated person is resold to an independent person. This price is afterwards reduced with a corresponding gross margin (the resale price margin) representing the value from which the last assistant from inside the club will try to cover the sale expenditures and other operation expenditures in accordance with the operations performed and to be able to realise a corresponding profit.

The following must be taken into consideration:

- The factors regarding the time period between the initial purchase and resale, including those referring to the changes happened, on the market, regarding the expenditures, the exchange rates and inflation;
- The modifications happened in the state and the wearing out degree of the goods that make the transaction object, including the modifications happened by the technological progress in a certain field;
- The exclusive right of the reseller to sell certain goods or rights that could influence the decision over some change of price margin.

An uncontrolled transaction is comparable to a controlled transaction, in the sense of resale price method, if:

- Neither of the differences between the compared transactions or between the persons that unroll these transactions cannot substantially affect the price from a free market; and if
- It cannot be made sufficiently precise adjustments to eliminate the effects of any difference between those mentioned above.

In the case in which there isn't possible the evaluation of transactions market price by using the methods presented above, it can be used any other method approved in the manageress lines regarding the transfer prices issued by the Organization for Cooperation and Economic Development.

These methods are:

- The method of net margin;
- The method of sharing the profit,

**The method of shared margin** implies the calculation of the net profit margin obtained by a person as a result of one or more transactions with affiliated persons and the estimation of this margin on the basis of the obtained level by the same person in transactions with independent persons, or on the basis of the margin obtained in comparable transactions performed by independent persons.

This method presumes the prosecution of a comparison between certain financial indicators of the affiliated persons, and the same indicators of independent persons that activate inside the same industry.

### **The method of sharing the profit**

It is used when the performed transactions among affiliated persons are interposed so that it is not possible the identification of some comparable transactions.

This method assumes the estimation of the obtained profit by the affiliated persons as a

result of one or more transactions and the sharing of those profits between the affiliated persons, proportionally with the profit that would have been obtained by independent persons. The sharing of the profit must be realized through an adequate estimation of the realized incomes and the bear costs, as a result of one or more transactions, by each person. The profits must be shared so that each one reflects the performed functions, the undertaken risks and the actives used by each of the affiliated parts.

In order to apply the above presented methods there isn't a unique succession to determine the market value, the succession that will be applied to all cases. The examination is based upon the established prices by the contributors. At the control of the application opportunity of a starting method is necessary to take into consideration:

- The method that is closed to the circumstances in which there are established the prices subjected to free competition on comparable market from a commercial point of view.
- The method for which there are available the most trusting data regarding the prices, resulted from the effective working of affiliated persons, involved in transactions subjected to free competition.
- The degree of precision with which it can be done adjustments in order to obtain comparability.
- The individual case circumstances.