Transfer prices - an international problem

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TRANSFER PRICES - AN INTERNATIONAL PROBLEM

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Abstract

The paper aims to highlight the importance of transfer pricing in the international economic environment, a topical subject, with a strong impact both on the affiliated companies and on the countries in which these companies operate.

It is important to emphasize that, at present, the transfer price is an important element in the activity of companies around the world, considering the changing business environment and the expansion of globalization. Also, setting transfer prices in a robust and fair way to all parties involved is one of the most important international tax issues.

Keywords: *transfer pricing strategy, international environment, arm length principle, phenomenology, price transfer, affiliated party transaction.*
JEL Classification: F23, F30, E 31

Introduction

The evolution of transfer prices is fully in line with the phenomenon of globalization, the development of trade relations between states and the emergence of the first multinational groups with operations in various states. In recent years, transfer prices have been a sensitive topic of both national and international interest. The purpose of this article is to present the aspects of transfer pricing and to answer the following two questions: what are the transfer prices and what is their link with the international environment.

The concept of transfer pricing is a topical subject to contradictory views. Once I get into the details, I notice that things are not that simple, the reality is much more complicated than it seems, because the situations in the economic environment are so different that the transfer pricing analysis can become extremely complex.

The level of knowledge in the field of transfer prices

Transfer pricing is one of the most important issues in international and national taxation. There are many studies that address this subject with particular emphasis on microeconomics and accounting literature. Often, however, only those related to the use of transfer pricing, such as the allocation of necessary resources, strategic use, cash management and the use of controlled management, are mentioned. In practice, there are several comprehensive reviews of this phenomenon (Eccles, 1985; Eccles and White, 1988); but in this article, the author will focus only on a few studies that are the range of transfer pricing research in different disciplines.

At international level, these prices are analyzed and set out from two perspectives: economic and accounting. According to Hirshleifer (1956), the economic outlook suggests that transfer prices are used by multinational companies to help autonomous profit centers make certain decisions that will lead to stronger profits. However, the accounting perspective highlights that the approach should help rather than hamper the process of performance analysis for profit centers and their managers (Benke and Edwards, 1980; Eccles, 1985 and 1991; Kaplan and Atkinson, 1989).

Tisdell (1989) talks about the use of transfer pricing in a multidisciplinary firm. It also points out in its research about areas neglected by the Transfer Pricing Guide, a sneak guide for the company's economic value, which can postpone technological innovation and maximize productivity within a division.

Cravens (1997) found, through an analysis, that multinational companies often use transfer prices both to obtain a competitive advantage and to achieve other corporate objectives. At the same time, it can be seen that this transfer use has an impact on corporate performance indices, so researchers agree that transfer pricing is not a tax-based mechanism. Just as prices facilitate transactions on foreign markets, internal transfer pricing allows profit centers to trade certain goods or services on domestic markets. Vancil (1978) states in a survey that, on average, the number of internally traded goods equals 10% of total sales or total cost of goods sold.

Alles and Datar (1998) in their studies, emphasize the use of costs for strategic purposes and at the level of oligopolistic companies, pricing decisions are based on costs provided to sales and marketing departments. They argue that there is certain evidence attesting each time the presence of a strategic component in choosing the cost system and setting transfer pricing, as well as the fact that companies can use their products to subsidize in order to obtain certain tax advantages.

The problem of transfer pricing is complex both for tax authorities and for multinationals, as the most important tax issue they face today. Lee Sheppard (2012) states that "transfer pricing is the edge of what is wrong with the international tax system." Starting from Lee Sheppard's definition, this article shows how these prices can be used to maximize profits through tax evasion and to obtain tax cuts.

According to Patroi (2013), "transfer prices are the" end-point of ingenuity in the area of tax legislation ", as they are the link between tax regulations existing in different national and international markets.

Sikdar (2006) explains how multinational companies were born, taking into account the organizational expansion and evolutionary stages in which a single owned business evolved into a multinational enterprise where the tasks and ownership of ownership are delegated through the board administrative and group companies that work together to meet the common objectives. Dawson and Miller (2000), also analyze the evolution of transfer pricing and claim that they are linked to organizational growth and the evolutionary stages of single business. Thus, the analysis of the fairness of the price used in the affiliate transactions occurs only if the transaction records lower profits than the ordinary tax authorities. Therefore, transactions made by affiliated parties located in different countries are based on transfer prices.

Urquidi (2008) notes that using transfer pricing, macroeconomic factors play an essential role, and companies will have to take into account these economic factors in order to address the process of setting them up. At the same time, he finds in his case study that companies want to solve the problem of setting transfer prices for certain reasons:

- because these prices meet the company's goals regarding internal strategy and incentives;

- come from an efficient use of internal and external resources;
- provide the optimal fiscal response.

Benke and Edwards (1980) have similar views on transfer pricing and analyzed these practices at 19 companies to identify policies that other firms might use in pricing strategies appropriate to their individual circumstances. On policy, Eccles (1985 and 1991); Eccles and White (1988) recall three of the most common transfer pricing policies: mandated transactions with total expense, market-mandated transactions and free trade, according to which prices vary between total cost and market.

Sikka and Willmott (2010) discuss some evidence to show that transfer pricing is not just an accounting technique, but they can also represent a method of allocating resources and avoiding taxes that negatively affect revenue distribution, wealth, risks and quality of life. In the same way, the authors Jelena and Danijel (2010) consider that this phenomenon affects the organization's revenues, costs and financial results. They believe that at the level of multinational groups, these prices lead to the emergence of competition that has the role of enhancing performance. Thus, for their establishment, the use of optimal methods plays a special role and is of great importance to managers.

The OECD Guidelines (2009) analyze the assessment methods to see if the multinational companies' commercial and financial relations respect the arm's length principle and discuss the practical application of these methods.

According to the study of the literature, the transfer prices were also analyzed through tax accounting studies assessing the stage in which national differences in the rate of tax lead to transfer pricing and income changes (Iacob, 1996; Swenson, 2001; Gupta and Mills, 2002); studies that lead to the choice of the optimal method of setting transfer pricing from a fiscal point of view (Swenson, 2001; Douvier, 2005); studies suggesting that these prices help maximize the value of businesses (Michaels, 2005); studies that consider tax rules as part of environmental factors (Emmanuel and Mehafdi, 1994; Cravens and Shearon, 1996; Cravens, 1997).

The transfer pricing field is a fairly controversial topic, with both supporters and critics, it all depends on their ability to use them in order to reduce the tax burden, taking advantage of the opportunities they offer. Conover and Nichols (2000) analyzed the influence of the enterprise's size on the use of transfer pricing to modify revenue. They have found that larger enterprises have more opportunities to modify their revenue through this method. Other studies have also provided evidence of the types of multinational enterprises that are more prone to manipulate transfer pricing. According to Jacob (1996), internationally, multinational companies have benefited from the most transfer opportunities and the most significant incentives to modify revenue. Transfer pricing at multinational companies can be used to: achieve internal and external targets; evaluating the performance of affiliates and their managers; motivating managers as an internal reason and reducing taxes.

Also, multinationals use transfer pricing to reduce exchange rate risk and position themselves better than competitors to hide fiscal success or maximize profit and minimize tax burden (Dawson, 2000; Mehafdi, 2000).

Methodology

This article is a qualitative research. of the main sources in the literature, based on logical analysis and generalization.

The subject of this investigation is the transfer price and its influence on the international environment. These transfer prices have occurred in the context of groups of companies with presence in more than one country carrying out economic activities in these locations, thus representing a complex end point.

Of the five types of qualitative research, this work belongs to phenomenology. A phenomenological study describes the significance of experiences experienced by many people about a concept or phenomenon (Creswell, 1998). This research is a descriptive study of a transfer price phenomenon, manifested in time and space. These transfer prices can be considered a complex phenomenon in the economy of a country, being used by taxpayers and analyzed by tax authorities.

Results and discussions

The issue of international transfer pricing can be managed taking into account the following aspects:

- planning - helps expand economically justifiable transfer pricing policies and address future-oriented tax solutions with long-term fiscal benefits;
- implementation is another way to optimize the development of policies, procedures, controls and systems for setting, supervising and testing intra-group transactions;
- knowing the risks incurred and identifying the assets used by the group in the group so that it can claim that the related parties have meaning and economic substance. In this way, it can also be argued that transfers have taken place at market price, and it is also necessary to comply with legislative regulations and to prepare risk management documentation in the context of extensive transfer pricing legislation, stringent documentation requirements, auditing practices sophisticated and significant penalties in case of non-compliance with the legislation in force.

Transfer pricing continues to be one of the most significant areas of tax risk faced by multinational companies, being used for various purposes by multinational companies in affiliated activities to carry out international transactions. Since transfer prices have important implications for Member States' budgets, there is an increasing complexity of tax issues for both tax administrations and companies that are required to comply with the different tax rules in the countries where they work. Different international tax rules generate conflicts of interest between tax administrations and companies, and the lack of administrative coordination between tax jurisdictions can support capital movements in some countries and loss of tax revenue.

Thus, the benefits and essential use of transfer prices reported during the research are as follows:

- the international transfer price can be used by multinational companies as a tool to ensure management control. Certain performance standards can be set for a business division, and transfer pricing is intended to facilitate the assessment of established performance. For example, this is true for operations involving export;
- play an essential role in risk management, as multinational companies' investments in new markets involve certain risks at global level;
- have an impact on the management of funds, investments and capital budgets, as international leaders are turning their attention to allocating funds for global investment.

The transfer of prices is considered to be as old as international transactions or inter-state transactions. In this situation, the analysis of the correctness of the price used in a transaction with an affiliated company occurs only if the party concerned is adversely affected, ie the transaction leads to unusual collections for the tax authorities. Thus, transactions between related parties located in different countries are subject to the use of transfer pricing.

Important observations and findings

1. The transfer price is used as a tool for managing debts other than corporate income tax. There are certain situations in which it is admitted that the main purpose of using them is to reduce tax liabilities. It can also be used as a management control tool and is an asset in its usefulness;
2. The reason for adopting the arm length principle is that it provides a treatment parity between independent and multinational companies, thus avoiding the creation of tax advantages or disadvantages that could distort the competitive positions of each type of entity;
3. The arm length principle is sometimes subjective and may offer flexibility in addressing the taxation problem resulting from strategic decisions to use the transfer price;
4. Transfer rates are used for strategic and investment purposes and can also be a method of managing international funds;
5. There are also some risks faced by multinational companies, such as the risk of entering a new market, and risk management always has a top priority in addition to the issue of pricing that does not follow the arm's length principle;
6. Certain criteria must be met to strengthen an effective international transfer pricing system for foreign operations. These criteria refer to the increase of the global profit of the multinational enterprise by minimizing the total debts on the profit tax, the costs of the international transactions, the losses in foreign currency; as well as stimulating managers in foreign divisions to increase efficiency and maximize profit, in line with leadership goals.

Conclusions

The international reasons for transfer pricing are a general perspective that is not limited to the management of tax liability. These pricing modalities are among the most diverse and include management control, investment and performance management of multinational companies.

Therefore, there is a need for transactions between affiliated entities to comply with the arm length principle without being influenced by the affiliation relationship between them. According to the details presented in the paper, the tax authorities need to carefully look at this area, as taxing transactions with affiliated parties at international level may sometimes be subjective and may present certain uncertainties for multinational companies that make certain decisions.

This paper presents a brief description of the concept of transfer pricing, analyzing the most important aspects of this phenomenon, as well as the reasons why these transfer prices are used in multinational companies. Therefore, the link between transfer pricing and the international environment is to determine whether the affiliate price is somewhat too low or too high so that the arm length principle is not respected.

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