

# [International transfer pricing: an on-going issue](https://assignbuster.com/international-transfer-pricing-an-on-going-issue/)

International Transfer Pricing has been an On-going Issue that needs to be addressed. By definition, transfer pricing when mentioned in any context brings about the meaning of pricing contributions which entails the assets, tangible and intangible along with services and funds transferred within an organization. Basically, it is like goods from the production being sold to the marketing division or rather goods from a parent company being sold to a foreign subsidiary (Abdallah, 2004). Transfer pricing can also be defined as the value placed on goods and services exchanged between affiliates or within the divisions of the company. From this point, it is important to point out that the transfer pricing is done in accordance to the dictates of Basic Arm's Length Standard. Depending on the jurisdictions that the affiliates do business in, they are as well subjected to the different tax rates. There are several objectives that lead to transfer prices which include the overall objective that is aimed at establishing a transfer price that will motivate effort and goal congruence. Along with this objective, transfer prices aid in evaluating the performance of the division in that the investment is centered on profits (Read & Gregoriou, 2007). Again in this line of thought, the transfer prices are aimed at maintaining the division autonomy in that decentralization and freedom to make decisions is granted. It is also given to the transfer prices to provide the buying segment with the information that is necessary for the buy or make question. For the countries that have realized the benefits that come along with the tax revenue that is brought about by transfer pricing, they have established laws with details on how to deal with transfer pricing (Markham, 2005). Others have ended up tightening the existing transfer pricing laws. Also, others are in the process of making investigation and research on how it works in order to embark on it. Principally, prices are set within an organization and thus typical market mechanisms that establish prices for this sort of transaction between third parties may not be practical. Notably, there is a great effect of the choice of the price that the entities choose while making the allocation of the total profit amongst the parts of the company presented. Arguably, this has evolved to become a major concern in the presence of fiscal authorities who so much worry of the multinational entities supposedly setting transfer prices on cross-border transactions with the sole aim of reducing taxable profits in their jurisdiction (Read & Gregoriou, 2007). Following this point, transfer pricing regulations as well as enforcement along with making transfer pricing as the major tax compliance issue especially for the multinational companies has been realized. From this point, International Transfer Pricing has been an On-going Issue that has been realized in the recent past especially in regard to international taxation. Due to variance in tax rates across different countries, many corporations have been prompted to operate in more than one country in order to shift their profits to low tax locations. In this context, this has resulted to tax revenue loss especially to the countries that are described by high tax regimes. In line with this, there has been established a transfer pricing legislature that is meant to ensure that tax avoidance has been limited. The tax avoidance is achieved through the manipulation of prices charged on intra-group cross border transactions in such a way as to minimize the taxable profits in low tax jurisdictions and minimize such profits in high tax countries (Markham, 2005). It has been noted with a lot of concern that the transfer pricing provisions are exhaustive in many respects and as such, they are in accordance with international practices that makes the prescription of methodologies, penalties and documentation requirements. Nonetheless, they fail to make provision to the taxpayer the facility of obtaining the Advance Pricing Agreement (APA). In the same line of thought, transfer pricing fails to address special situations of intangibles, e-commerce, global trading derivatives and others as such that require or rather that calls for special consideration. Needless to say, although transfer pricing is a necessary tax provision that makes possible to get revenue from international transactions, it should be noted that administrative of it altogether should be handled with sensitivity. Outstandingly, with respect to the recent global business structures, intra group transfers of technology, management services, and intra-group transfers of technology, management services and financial loans happen to move around within the multinational corporations (Read & Gregoriou, 2007, p. 115). In this sense, in tax terminology, the pricing of intra-group transactions is normally assessed by means of transfer pricing methods of which there are six categories that are recognized internationally for purposes of tax. Basically, the framework that is fit for the application of TPMs, is made provision of by the internationally accepted arm's length principle (ALP). This principle provides that the transfer price shall be in line with a price that has been agreed on as third parties in a comparable market transaction (Abdallah, 2004). Besides this, the emergence of national documentation requirements that are implemented by an increasing number of national tax authorities meant to enforce MNCs have now become aware of the need to set non-manipulated transfer prices for delivering goods and services within MNCs. Associated with cross country differences in accounting and provisions of tax, transfer pricing has become a game of dice for the tax authorities and the tax payer owing to the unpredictable governance (Read & Gregoriou, 2007). As a result, there has been the issue of today's tax bases of multinationals being generally underestimated apart from the fact that there has been a search for prices that are appropriate. Above and beyond, the transfer pricing has been faced by vagueness, fuzziness, lack of transparency and premature concepts. Due to these factors, there is need for the taxpayer and the tax authorities to agree on some issues while determining the price to settle on and the amount of tax to pay for. Taking the example of a high tax regime country, if the expenses are deducted in the course of the development of the production site, then, the MNC may have reason to shift to a low tax and or low wage country at a moment when the product is in a position to produce as well as generate high products (Markham, 2005). Generally, the identification of the MNCs relevant tax base along with the allocation of this tax base into the jurisdiction in which the multinational carries its operations, it provides a key problem that faces the corporate income taxation. Along with this, it is important to put it that there has been an ongoing issue of international taxation in relation to transfer pricing in that there is careful approach that is required of which if not applied, there would be a lot of disputes due to the mishandled transfer pricing. In order to address this problem, there are several solutions that have been pointed out. As such, there have been steps that have been taken with the sole aim of harmonizing international corporate income taxation. In consistent with this, there has been the dense net of double tax treaties, the OECD Model Tax Convention, and the OECD transfer price guidelines or rather the so called initial attempts of the EU tax harmonization process (Read & Gregoriou, 2007). Generally, the institutionalization of this international taxation is in infancy and altogether underdeveloped being characterized by a low level of harmonization in regard to cross country procedures if it may be said. The lack of harmonization is brought about by the issues of international taxation along with the requirements that come along with it. In the current type of economy of which it is practically receding, there are several issues that face the effort towards developing an effective global pricing policy. In line with this, the current economic downturn has been associated with reduced personal income as well as corporate profits as well as potential significant corporate losses. As a result, this puts pressure on the taxing authorities world wide to become more aggressive in the collection of revenue that is necessary to support the needs of the government. Following this point, efforts towards developing an effective global transfer pricing may be challenged in that the transfer pricing disputes are inevitable. As a consequence, it is expected of the multinational companies to prepare to make a defense of historical inter-company pricing policies. In line with this, pricing policies as well as results should be achieved through profit based and transaction based pricing methods. Accordingly, multinational companies should take in consideration well documentation of transfer pricing policies and inter-company transactions as they would increase (Read & Gregoriou, 2007). Subsequently, the taxpayers should consider building flexibility into the transfer pricing policies through the inter-company contracts with APAs which may allow for revisions of the pricing policies with related parties along with taxing authorities. Economy downturn in addition, it is able to lead to a variety ways in modifying transfer prices. More to this point, the taxpayers are subjected by the receding economy to flexible royalties, consideration of loss comparables, profit splits, modification of number of years that are analyzed together with targeting different position in the range (Organisation for Economic Co-operation and Development, 2001). Another point to note is the effect that the change from U. S GAAP to International Financial Reporting Standards (IFRS) and the impact they have had on the developing an effective global transfer pricing policy. Research has pointed out that this transition has profound effects on the transfer pricing based on the comparable profits methods (CPM) or the comparable uncontrolled price (CUP). Arguably, companies that make use of the profit based methods such as CPM or profit split methods in conjunction with external benchmarks to set or test their transfer prices, under the IFRS they would be greatly affected by the transition (Markham, 2005). On the other hand, the multinational companies that make use of the transaction based methods such as CUP, resale price or cost plus together with the use of internal benchmarks to set or test their transfer prices will be least affected compared to the former as highlighted. Fundamentally, a company that was using arm's length standard for reporting its financial performance cannot be limited to meet the standards in another accounting standard framework. This is to suggest that conceptually, the transition from one accounting standard framework cannot prevent one who is committed to meet the arm's length standard from doing so(Markham, 2005). From another point of view, the shift to IFRS will affect the full range of corporate processes. Additionally, the multinational companies will end up facing significant tax ramifications that affects the companies in the countries whereby they operate. Overall, there may be immediate impacts on multinational company processes especially with the tax rate. Despite the above mentioned effects of IFRS on the operations of multinational companies, it can be said that there are both positive and negative effects. Since the negative ones have been explained, there are positive ones which are associated with the fact that they may make the implementation of transfer pricing to become eventually easier (Levey, Steven & Kerwin, 2006). From a broader point of view, there is potential impact of this changeover between two financial reporting standards on a company's inter-company pricing policies and on the methods used to test whether the policies meet the terms of the arm's-length standard widely adopted by most tax jurisdictions. Following the internal Revenue code especially in the U. S, it is the main body that is responsible for statutory tax law of the united states which is organized including laws that govern the income tax, Payroll taxes, gift taxes and estate tax among others. As it has been highlighted earlier in this work, the transfer price issue is an issue that becomes a main concern of a third party who may be the tax authorities. In connection to this, the motivation in this case would be to make a shift of profits from a high tax rate location to a lower one (Read & Gregoriou, 2007). In essence, this can be achieved by manipulating the transfer prices. As a matter of fact, the internal Revenue code or service in this matter is entitled to challenge an inappropriate transfer prices in the course of the audits. The sole aim of the internal Revenue code was written in order to set tax rules along with guidelines for the acceptable transfer of pricing and cost allocations given between affiliates (Markham, 2005). According to the treasury regulations that are committed to interpret the internal revenue code in relation to transfer pricing in the inter-company service transactions, the IRS is authorized to make an appropriate allocation of one member of a group of controlled entities that performs services for another at a charge that does not really reflect an arm's length consideration. Taking the example of the U. S, the treasury regulations along with IRS is to manage and harmonize the Current Services Regulations with the transfer pricing rules for transfers of tangible and intangible property. It has in fact been promising to issue new regulations to update the Current Services Regulations for the new business environment in which MNCs operates as they are presented to many challenges in regard to taxation of the transfer pricing (Read & Gregoriou, 2007). Notably, the internal Revenue service has been offering taxpayers the opportunity to reach agreement in advance of filing a tax return on the appropriate transfer method to be applied to the related party transactions. This is accomplished by means of the APAs. In the same line of thought, the service is also updated for the procedural rules for processing and administering APAs (Organisation for Economic Co-operation and Development, 2001). More specifically, the APA program can be described in this context as a voluntary process through which the internal revenue service may resolve the issues of transfer pricing under the internal revenue code. It is also done under the income tax regulations whereby the transfer pricing principles may happen to be relevant. It attributes profits to a permanent establishment which is under the treaty of income tax. In conjunction with this, it determines the amount of income that is derived partly from the U. S and partly outside. Factoring in this point, the APA process is associated with the increased efficiency of tax administration as it encourages the taxpayers to come forward and make a presentation to the service of the facts presumed to be proper for transfer pricing analysis (Levey, Steven & Kerwin, 2006). Likewise, it encourages cooperation and openness among the involved parties. Outstandingly, the APAs ensure that the burden of compliance is reduced as they provide the taxpayers with greater certainty in regard to transfer pricing methods. From a broader point of view, it promotes the principled resolution of the issues that concerns transfer pricing by making an allowance for both discussion and resolution before the repercussions are exposed to the taxpayers and the Internal Revenue Service. From the above provided information, it is important at this point to bring out the overview of the whole issue about transfer pricing as it relates to international taxation. There are various current view points as well as approaches that have been employed in order to deal with the transfer pricing at an international level in relation to international taxation. International taxation in particular subjects the transfer pricing especially at cross country to a global point of view. So to articulate, there is a growing need for development of a global transfer pricing policy as the world is becoming a global market world. Just as it has been provided elsewhere in this work, the economic recession has had great effects on the transfer pricing in that disputes are on the increase as well as the fact that there is need for standardized international taxation. As such, economic downturn has affected the efficiency and the development of an effective global transfer pricing policy since economic recession has led to a lot of changes as well as instabilities. Furthermore, the IFRS implementation has also challenged the transfer pricing to thrive in the international trade due to different rates of taxes along with changing policies from the U. S GAAP to IFRS. Finally in this case, there has been the inclusion of Internal Revenue Code; the Treasury Regulations; Internal Revenue Services Revenue Rulings and Procedures that are involved in transfer pricing in relation to international taxation.