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**INTERNATIONAL TRANSFER PRICING**

***Transfer pricing*** refers to the determination of the price at which transactions between related parties will be carried out. Transfers can be from a subsidiary to its parent (upstream), from the parent to a subsidiary (downstream), or from one subsidiary to another of the same parent. Transfers between related parties are also known as ***intercompany transactions.*** Intercompany transactions represent a significant portion of international trade.

**TRANSFER PRICING METHODS**

1. ***Cost-based transfer price***: The transfer price is based on the cost to produce a good or service. Cost can be determined as variable production cost, variable plus fixed production cost, or full cost, based on either actual or budgeted amounts (standard costs). The transfer price often includes a profit margin for the seller (a “cost-plus” price). Cost-based systems are simple to use, but there are at least two problems associated with them. The first problem relates to the issue of which measure of cost to use.

2. ***Market-based transfer price:*** The transfer price charged a related party is either based on the price that would be charged to an unrelated customer or determined by reference to sales of similar products or services by other companies to unrelated parties. Market-based systems avoid the problem associated with cost-based systems of transferring the inefficiencies of one division or subsidiary to others. They help ensure divisional autonomy and provide a good basis for evaluating subsidiary performance.

3. ***Negotiated price***: The transfer price is the result of negotiation between buyer and seller and may be unrelated to either cost or market value. A negotiated pricing system can be useful, as it allows subsidiary managers the freedom to bargain with one another, thereby preserving the autonomy of subsidiary managers.

**OBJECTIVES OF INTERNATIONAL TRANSFER PRICING**

**Performance Evaluation**

To fairly evaluate the performance of both parties to an intercompany transaction, the transfer should be made at a price acceptable to both parties. An acceptable price could be determined by reference to outside market prices (e.g., the price that would be paid to an outside supplier for a component part), or it could be determined by allowing the two parties to the transaction to negotiate a price.

**Cost Minimization**

When intercompany transactions cross national borders, differences between countries might lead an MNC to attempt to achieve certain cost-minimization objectives through the use of discretionary transfer prices mandated by headquarters. The most well-known use of discretionary transfer pricing is to minimize worldwide income taxes by recording profits in lower-tax countries.