INTERNATIONAL TRANSFER PRICING

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**Summary of international transfer pricing**

Transfer pricing is the rules and methods for pricing transaction within and between enterprises under common ownership or control. It happens whenever two companies that are part of the same multinational group trade with each other. Transfer pricing is one of the most important issues in international tax.

Intercompany transactions are transfers between related parties and it represent a significant portion of international trade. The two factors that influence the way in which international transfer prices are determined are:

* The objective of the management of the headquarters
* The existing law in most countries governing the manner in which intercompany transactions crossing their borders may be priced.

Business enterprises are organized by division. A division may be a profit centre, responsible for revenues and operating expenses, or an investment centre, responsible also for assets.

**Transfer pricing method**

There are three methods which are commonly used:

* Cost-based transfer pricing: it is a method of setting prices when goods are sold to divisions within the same company, 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. The other problem is that inefficiencies in one unit may be transferred to other units, as there is no incentive for selling divisions to control costs.
* Market-based transfer pricing: it is the act of setting prices that are closely aligned with the current market price of similar products. Market-based systems avoid the problem associated with cost-based systems of transferring the inefficiencies of one division or subsidiary to others.
* Negotiated price: it may be necessary to negotiate a transfer price between subsidiaries, without using any market price as a baseline. 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: it is a formal and productive procedure to measure an employee’s work and results based on their job responsibilities. 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.
* 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. It is to identify the area in which a business can effectively reduce costs that will have the most beneficial effect on profit maximization.