**16/SMS02/030**

**INTERNATIONAL TRANSFER PRICING**

Transfer pricing refers to the determination of the price at which transactions between related parties will be carried. It can be upstream or downstream (from subsidiary to parent and vice versa) or from one subsidiary to another of the same parent. Transfers between related parties are also known as intercompany transaction.

Two factors heavily influence the manner in which international transfer prices are determined. The first factor is the objective that headquarters management wishes to achieve through its transfer pricing practices. One possible objective relates to management control and performance evaluation. The second factor is the law that guides the manner in which intercompany transactions crossing their borders may be priced.

**DECENTRALIZATION AND GOAL CONGRUENCE**

Business enterprises often are organized by a profit centre or investment centre. The price at which an intercompany transfers is made determines the level of revenue generated by the seller, becomes a cost for the buyer and therefore affects the operating profit and performance of both related parties. To achieve this, transfer prices should motivate local managers to make decisions that enhance corporate performance, while at the same time providing a basis for measuring, evaluating, and rewarding local manager performance in a way that managers perceive as fair. If this does not happen (i.e., if goal congruence is not achieved), then the potential benefits of decentralization can be lost.

**TRANSFER PRICING METHODS**

The methods used in setting transfer prices in an international context are essentially the same as those used in a purely domestic context

1. Cost based transfer: The transfer price is based on the cost to produce a good or service. Cost based systems are simple to use. They may be problems which relates to the issue of measures to use and inefficiencies from a unit to another unit.
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.
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 allows subsidiary managers the freedom to bargain with another, thereby preserving the autonomy of subsidiary managers.

**OBJECTIVES OF INTERNATIONAL TRANSFER PRICING**

Performance Evaluation: In this case, the transfer should be made at a price acceptable to both parties. An acceptable price 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 MNC to attempt to achieve certain cost-minimization objectives through the use of discretionary transfer prices mandated by headquarters.

In conclusion, there may be inherent conflict which arises between these objectives. Other cost minimization objectives are; minimization of tariffs, avoidance of WHT etc.