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ASSIGNMENT: SUMMARY OF THE NOTE ON INTERNATIONAL TRANSFER PRICING

Transfer pricing refers to the determination of the price at which transactions between related parties will be carried out. Transactions between related parties is also known as intercompany transactions.

In establishing international transfer prices, multinational corporations often must walk a fine line between achieving corporate objectives and complying with applicable rules and regulations.

DECENTRALIZATION AND GOAL CONGRUENCE

Business enterprises are usually organized by division, in such enterprises, top managers delegate or decentralize authority and responsibility to division managers. The advantages of decentralization include; Allowing local managers to respond quickly to a changing environment, dividing large, complex problems into manageable pieces and motivating local managers. It also has disadvantages which most importantly is that local managers who have been granted decision-making authority may make decisions that are in their self-interest but detrimental to the company as a whole.

Goal congruence is when the corporate accounting and control system are designed in such a way that it provides incentives for local managers to make decisions that are consistent with corporate goals.

TRANSFER PRICING METHODS

* Cost-based transfer price: The transfer price is based on the cost to produce a good or service.
* Market-based transfer price: The transfer price charged to a related party is either based on the price that would be charged to an unrelated customer or on the price other companies sell similar products to unrelated parties.
* Negotiated price: The transfer price is the result of negotiation between buyer and seller and may be unrelated to either cost or market value.

OBJECTIVES OF INTERNATIONAL TRANSFER PRICING

This includes; 1) performance evaluation and 2) cost minimization.

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.

Cost Minimization: in international trade, 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. This is mostly used to minimize worldwide income taxes by recording profits in lower-tax countries.

Apart from minimizing taxes, a number of other objectives can be achieved through the use of discretionary transfer prices for international transactions. They include: avoidance of withholding taxes, minimization of import duties (tariffs), protect cash flows from currency devaluation and improving competitive position of foreign operation.

CONFLICTING OBJECTIVES

 There is an inherent conflict between the performance evaluation and cost- minimization objectives of transfer pricing. To minimize costs, top managers must dictate a discretionary transfer price. One way that companies deal with this conflict is mostly through dual pricing.