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**INTERNATIONAL TRANSFER PRICING**

INTRODUCTION

***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).Transfers between related parties are also known as ***intercompany transactions.*** Intercompany transactions represent a significant portion of international trade. Two factors heavily influence the manner in which international transfer prices are determined. The first factor is possible objective relates to management control and performance evaluation. The second factor is the law that exists in most countries governing the manner in which intercompany transactions crossing their borders may be priced. These laws were established to make sure that multinational corporations (MNCs) are not able to avoid paying their fair share of taxes, import duties, and by virtue of the fact that they operate in multiple jurisdictions. In recent survey, transfer pricing as the most important issue they face compared to all other international tax issues.

**DECENTRALIZATION AND GOAL CONGRUENCE**

Business enterprises are organized by ***division***. In a company organized by division, top managers delegate or decentralize authority and responsibility to division managers. ***Decentralization*** has many advantages, which are allowing local managers to respond quickly to a changing environment and dividing complex problems into manageable pieces. The corporate accounting and control system should be designed in a way that it provides incentives for local managers to make decisions that are consistent with corporate goals. This is known as ***goal congruence***. The system used for evaluating the performance of decentralized managers is an important component in achieving goal congruence. To achieve this, transfer prices should motivate local managers to make decisions that enhance corporate performance, 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 potential benefits of decentralization can be lost. For MNCs, there are additional factors that influence international transfer pricing policy.

**TRANSFER PRICING METHODS**

There are three methods which are commonly used: Cost-based transfer price, Market-based transfer price, negotiated price.

**OBJECTIVES OF INTERNATIONAL TRANSFER PRICING**

There are two possible objectives to consider in determining the appropriate price at which an intercompany transfer that crosses national borders should be made: (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. An acceptable price could be determined by reference to outside market prices or it could be determined by allowing the two parties to the transaction to negotiate a price. In addition, as upper management makes corporate resource allocation decisions, fewer resources may be allocated to this unit because of its lower reported profitability.

**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.