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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 upstream, downstream or from one subsidiary to another of the same parent. Transfers between related parties are also known as intercompany transactions.

The two factors that heavily influence the manner in which international transfer prices are determined are the objective that headquarters management wishes to achieve through its transfer pricing practices One possible objective relates to management control and performance evaluation. Another objective relates to the minimization of one or more types of costs and secondly, the law that exists in most countries governing the manner in which intercompany transactions crossing their borders may be priced.

DECENTRALIZATION AND GOAL CONGRUENCE

A division may be a profit centre, responsible for revenues and operating expenses, or an investment centre, responsible also for assets. Top managers delegate or decentralize authority and responsibility to division managers in a company organised by divison.

Some advantages of decentralization include Allowing local managers to respond quickly to a changing environment, dividing large, complex problems into manageable pieces, Motivating local managers who otherwise will be frustrated if asked only to implement the decisions of others.

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

The methods used in setting transfer prices in an international context are essentially the same as those used in a purely domestic context. The following three methods commonly used are; Cost based, market based and negotiated transfer price.

There are two possible objectives to consider in determining the appropriate price at which an intercompany transfer that crosses national borders should be made. These includes: (1) performance evaluation and (2) cost minimization. To fairly evaluate the performance of both parties to an intercompany transaction, the transfer should be made at a price acceptable to both parties.

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.

Conflicting Objectives is an inherent conflict between the performance evaluation and cost- minimization objectives of transfer pricing. One way that companies deal with this conflict is through dual pricing.

Other cost minimization objectives includes; Avoidance of Withholding Taxes, Minimization of Import Duties (Tariffs), Circumvent Profit Repatriation Restrictions, Protect Cash Flows from Currency Devaluation, Improve Competitive Position of Foreign Operation.