**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 from a subsidiary to its parent (upstream), from the parent to a subsidiary (downstream), or from one subsidiary to another of the same parent. Transfers between related parties are also known as intercompany transactions***.*** Intercompany transactions represent a significant portion of international trade.

# DECENTRALIZATION AND GOAL CONGRUENCE

Business enterprises often 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. 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

1. Cost-based transfer price: The transfer price is based on the cost to produce a good or service. Cost can be determined as variable production cost, variable plus fixed production cost, or full cost, based on either actual or budgeted amounts (standard costs). The first problem relates to the issue of which measure of cost to use.
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. The efficient working of a market-based system depends on the existence of competitive markets and dependable market quotations.
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 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

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.

# Cost Minimization

The most well-known use of discretionary transfer pricing is to minimize worldwide income taxes by recording profits in lower-tax countries. This objective can be achieved by establishing an arbitrarily high price when transferring to a higher-tax country. Conversely, this objective is also met by selling at a low price when transferring to a lower-tax country.

**Other Cost-Minimization Objectives**

1. Avoidance of Withholding Taxes: A parent company might want to avoid receiving cash payments from its foreign subsidiaries in the form of dividends, interest, and royalties on which withholding taxes will be paid to the foreign government.
2. Circumvent Profit Repatriation Restrictions:Some countries restrict the amount of profit that can be paid as a dividend to a foreign parent company. This is known as a profit repatriation restriction.