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**16/SMS02/048**

**SUMMARY OF INTERNATIONAL TRANSFER PRICING NOTE**

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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. 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. Another objective relates to the minimization of one or more types of costs. These two types of objectives often conflict. **The second factor** affecting international transfer pricing 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 so on by virtue of the fact that they operate in multiple jurisdictions.

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. In a company organized by division, top managers delegate or decentralize authority and responsibility to division managers decentralization has its advantages one of which includes dividing large, complex problems into manageable pieces and it also has it’s disadvantage which includes managers making self- beneficial decisions for the company as a whole.

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 are commonly used:

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).
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 can be useful, as it allows subsidiary managers the freedom to bargain with one another, thereby preserving the autonomy of subsidiary managers.

There are 2 objectives of international transfer pricing which are performance evaluation and cost minimization. **Performance evaluation** simply refers to fairly evaluating 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** refers to an 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. There is an inherent conflict between the performance evaluation and cost- minimization objectives of transfer pricing. Other cost minimization objectives include avoidance of withholding taxes, minimization of import duties, protection of cashflow from currency devaluation and to improve competitive position of foreign operations. Some of this cost minimization objectives can still conflict with one another.