**Ahmed Al-Amin Taiwo**

**17/SMS02/065**

**ACC 406**

**International Transfer Pricing**

The determination of the price at which transactions between related prices are carried out is transfer pricing and can be done between subsidiary and parent in an upstream or downstream manner or subsidiary and subsidiary under the same parent. Intercompany transactions refer to transfers between related parties and this forms a significant portion of international trade.

Two factors heavily influence how international transfer prices are determined; the first is what the management want to achieve with the transfer pricing practice such as minimization of cost and the second is is the law that governs the manner in which intercompany transactions crossing their borders may be priced and this laws exist to make sure Multinational Companies (MNCs) pay their fair share of taxes.

Decentralization involves organizing a business enterprise into divisions with top managers decentralizing authority and responsibility to division managers and it has its advantages such as; quick responses to changing environments, breaking complex problems into smaller pieces, motivation of local managers. It also has disadvantages such as local managers making decisions in their own interest. Goal congruence should be aimed for when implementing decentralization.

Intercompany transfers affect the operating profit and performance measurement of both related parties therefore appropriate transfer prices ensure that each division’s profit reflects its contribution to overall company profits.

Transfer pricing methods are the same in an international context and in a purely domestic context and they are three; the cost-based transfer price which is based on the cost of production, it usually includes profit margin for the seller , it is simple to use but has the problems of which measure of cost to use and inefficiencies in one unit often affects the rest but the use of standard, as opposed to actual, cost alleviates this problem; the second is the market-based transfer price which is charged based on price charged to unrelated parties or reference to another company’s sale of a similar product, it avoids the problem of inefficiencies affecting the cost-based method but has the problems of efficiency depending on competitive markets and market quotations and also the fact that they are the only sellers of a product; the third is the negotiated price which is a negotiation between buyer and seller and this ensures freedom of parties but the disadvantage is that it might take a long time.

There are two possible objectives to consider in intercompany transfer pricing that crosses national borders; the first is performance evaluation and in order to do this, transfers should be made at an acceptable price for both parties; the second is cost minimization which can be achieved by achieving an arbitrarily jigh price when transferring to a higher tax country and vice-versa. These two objectives conflict as to minimize costs, top managers must dictate a discretionary transfer price and this betrays the consent of the two managers involved but this can be solved by dual pricing.

Other cost-minimization objectives include avoidance of withholding taxes, minimization of tariffs, circumvention of profit repatriation restrictions, protection of cash flows from currency devaluation and improvement of competitive position of foreign operations.