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INTERNATIONAL ACCOUNTING

SUMMARY ON INTERNATIONAL TRANSFER PRICING

Transfer pricing refers to the price at which goods will be transferred between related parties. This can be between parent and subsidiary or between two subsidiaries. There are certain factors that influence the way international transfer pricing is determined. 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.

Business enterprises are often categorized as divisions. In a company organized by division, top managers delegate or decentralize authority and responsibility to division managers. Decentralization has many advantages, including the following: 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. In companies organized by division, supervisors delegate work to their subordinates. This has advantages as well as some disadvantages.

There are several methods of transfer pricing which are:

1. Cost based transfer price: Under this, goods are transferred at cost price which can be determined in different ways.
2. Market based transfer price: Under this, goods are transferred at a price that would be sold to an unrelated customer or unrelated party.
3. Negotiated price: Under this, goods are transferred a price agreed by both partners after negotiation.

There are two objectives of transfer pricing:

1. Performance evaluation
2. Cost minimization

There is an inherent conflict between the performance evaluation and cost- minimization objectives of transfer pricing. To minimize costs, top managers must dictate a discretionary transfer price. By definition, this is not a price that has been negotiated by the two managers who are party to a transaction, nor is it necessarily based on external market prices or production costs. The benefits of decentralization can evaporate when headquarters managers assume the responsibility for determining transfer prices.One way that companies deal with this conflict is through dual pricing. The official records for tax and financial reporting are based on the cost-minimizing transfer prices.

Other cost minimization objectives

1. Avoidance of Withholding Taxes
2. Minimization of Import Duties (Tariffs)
3. Circumvent Profit Repatriation Restrictions
4. Protect Cash Flows from Currency Devaluation
5. Improve Competitive Position of Foreign Operation