**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. 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. Another objective relates to the minimization of one or more types of costs.

**TRANSFER PRICING METHODS**

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.

**OBJECTIVES OF INTERNATIONAL TRANSFER PRICING**

1. 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 (e.g., the price that would be paid to an outside supplier for a component part), or it could be determined by allowing the two parties to the transaction to negotiate a price.
2. Cost minimization: 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.

**Other Cost-Minimization Objectives**

In addition to the objective of minimizing worldwide income taxes, a number of other objectives can be achieved through the use of discretionary transfer prices for international transactions. They include:

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