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**COURSE CODE: ACC406**

**COURSE TITLE: INTERNATIONAL ACCOUNTING**

**ASSIGNMENT: SUMMARY OF INTERNATIONAL TRANSFER PRICING**

Transfer pricing refers to the determination of the price at which transactions between related parties will be carried out. Transfers between related parties are also known as inter-company transactions. Inter-company transactions represent a significant portion of international trade.

Two factors heavily influence the manner in which international transfer prices are determined:

* The factor is the objective that headquarters management wishes to achieve through its transfer pricing practices.
* The factor affecting international transfer pricing is the law that exists in most countries governing the manner in which inter-company transactions crossing their borders may be priced.

**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.

**ADVANTAGES OF DECENTRALIZATION**

* 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.

**DISADVANTAGES OF DECENTRALIZATION**

local managers who have been granted decision-making authority may make decisions that are in their self-interest but detrimental to the company as a whole.

The designed in which it provides incentives for local managers to make decisions that are consistent with corporate goals is known as GOAL CONGRUENCE.

**TRANSFER PRICING METHODS**

* **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).
* **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. Market-based systems avoid the problem associated with cost-based systems of transferring the inefficiencies of one division or subsidiary to others.
* **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 inter-company transaction, the transfer should be made at a price acceptable to both parties.
* **Cost Minimization**: When inter-company 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,

**Cost-Minimization Objectives**

* **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.
* **Minimization of Import Duties (Tariffs):** Countries generally assess tariffs on the value (based on invoice prices) of goods being imported into the country.
* **Protect Cash Flows from Currency Devaluation:** In many cases, some amount of the net cash flow generated by a subsidiary in a foreign country will be moved out of that country, if for no other reason than to distribute it as a dividend to stockholders of the parent company.