TRANSFER PRICING AND ITS TAX IMPLICATIONS

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INTRODUCTION

A transfer price is a price on goods and services one member of a corporate family sells to another. Transfer pricing or intracompany pricing refers to the pricing of goods transferred from operations or sales units in one country to the company's unit elsewhere. The appropriate basis for intracompany transfers often depends on the nature of the subsidiaries, the market conditions and government policies and regulations. Transfer prices remain the absolute prerogative of the parent company executives regardless of the firm's nationality.

ORIGIN

Transfer pricing adjustments have been a feature of many tax systems since the 1930. Both the U.S and the Organization for Economic Cooperation and Development (OECD) had some guidelines by 1979. The United States led the development of detailed, comprehensive transfer pricing guidelines with a White Paper in 1988 and proposals in 1990-1992, which ultimately became regulations in 1994.[1] In 1995, the OECD issued the first draft of current guidelines, which it expanded in 1996. The two sets of guidelines are broadly similar and contain certain principles followed by many countries. The OECD guidelines have been formally adopted by many European Union countries with little or no modification.

CRITERIA FOR THE APPLICABILITY OF TRANSFER PRICING

A transfer pricing strategy can be applied only if the following requirements are fulfilled by the persons those who have involved between the transactions.

- At least one of the parties to the transaction should be non- resident.
- It should be based on internationally accepted principles.
- Income should derive from international transactions.
- It must define to average transaction between associated enterprises in all types of property, provision of services, finance, etc.
- It should adjust and increased in taxable income and reduced taxable losses.
- Transfer pricing includes allocation / apportionment of costs.

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OBJECTIVES OF TRANSFER PRICING SYSTEMS:

OECD has formulated the statutory guidelines to the parties involved in international transaction with the adjustment of fund between one and another to reach and facilitate themselves in addition to the following goals.

- To maximize the total profit of the company.
- To facilitate parent company control.
- To offer management at all levels, both in the product divisions and in the international divisions, an adequate basis for maintaining, developing, and receiving credit for their own profitability.

TRANSFER PRICING AND TAXATION:

Companies establish arbitrary transfer prices primarily because of differences in taxations between countries. The OECD is very concerned about the ways companies manipulate to minimize their tax liability worldwide. They suggest that the tax liability in each country, an arm's length unit (ALU) method should be applied. ALU is a transfer pricing, that is a between two companies that do not have an ownership interest in each other. This assumption is that an arm's length price is more likely than a transfer price to reflect the market accurately.

- **COMMON PRICING ARRANGEMENTS FOR TRANSFER PRICING:**

- ✓ Sales at the local manufacturing cost plus a standard mark-up.
- ✓ Sales at the cost of the most efficient producer in the company plus a standard mark-up.
- ✓ Sales at negotiated prices.
- ✓ Arm's length sales using the same prices as quoted to independent customers.

Most governments have granted authorization to their tax authority to adjust prices charged between related parties. The primary moto of the government in applying the strategy of the transfer pricing is to eliminate the tax evasion and tax avoidance in the mindset of the tax payers. The adjustment of transfer pricing only within the jurisdiction. It can be possible only after filing of tax returns which should be made only of actual transactions involved between enterprises. Multiple transactions may be tested by using multiple year date.

STRATEGIES ASSOCIATED WITH TRANSFER PRICING:

- ➢ When goods are shipped to high-tariff countries, minimal transfer prices are quoted to reduce the effect of duty. Because of the reduction of the home country tariff which will be compensating to the buyer or seller through ALU.

- To reduce income tax, goods are overpriced when transferred to units in high-tax countries. The primary purpose of transfer pricing is to prevent international double taxation by withholding the tax and exemptions for royalty, the proportionate income tax level will be moderated and ultimate benefit transferred to the tax treaties.
- When dividend repatriation is curtailed by government policy, income may be taken. In transfer pricing strategy, Central Board of Direct Tax (CBDT) has a separate class under section 92 to relax the dividend income. It may be helpful to the beneficiary to enjoy a tax concession with tax holidays benefits.

DISPUTES IN TRANSFER PRICING:

Even though there is a strong guidelines by the OECD, the purposeful dispute arise between the parties in involving the fund transfer between another. Glaxo Smithkline, the British Pharmaceutical company faced the transfer pricing dispute in the year 2006 and that rectified by paying dollar 3.1billion in the form of local taxes and interest. The dispute arose only due to heavy levy of marketing service cost to the independent third party. The significant financial risks levered through rational operating cost component.

CONCLUSION:

Inspite of tightening the accounting standards, derivatives will be a big helpful to the companies as they attempt to hedge their cash flows through transfer pricing and protest against erosion of earnings in an unstable financial environment. The OECD, the IMF and The EU are three institutions that will help the countries narrow their tax differences and crack down on the transfer of money for their illegal purpose. Although illegal financial transactions have occurred for years, especially due to drug trafficking to the reform of the financial global system. Companies will significantly reduce the paper flow and increase the speed the delivery or transfer of funds enabling them to manage cash and to use intercompany resources much more effectively. With this, the author concluded that the formal approach and viability of the transfer pricing will be benefit to the country as well as the tax payers to the upliftment of the economic growth.