The Impact of Transfer Pricing on Financial Reporting: A Nigerian Study

Adum Ovunda Smith
Rivers State University of Science and Technology, P.M.B 5080 Nkpolu Oroworukwo, Port Harcourt, Nigeria.

Abstract
The issue of transfer pricing arises where companies are divisionalised and have responsibility centres operating as strategic business units. This kind of situation is associated with the challenge of determining suitable prices for intra-group transactions. The transfer pricing problem becomes even more critical where a company has subsidiaries spread around the world especially in countries that have varying tax rates. Under this situation, it is common for multinational companies to attempt to minimise their tax liabilities by shifting profits from higher tax countries to lower tax regimes. Of course tax authorities all over the world are not comfortable with this kind of arrangement. Thus efforts are being made like what the FIRS is doing in Nigeria to stop it. The issue of transfer pricing as it relates to financial reporting is usually associated with uncertain tax positions in terms of the extent to which tax reserves may need to be recorded due to uncertainty with respect to tax return position. Transfer pricing has income tax consequences which of course, is more pronounced when the parties to a transaction are taxed in different jurisdictions. So it is really a problem for multinational companies and governments all over the world. Therefore, this study was carried out to examine the impact of transfer pricing on financial reporting. And it was gathered that governments and multinational companies in Nigerian and those of other developing countries world over are constrained by the required resources to be able to effectively implement transfer pricing. Nevertheless, it is strongly recommended that appropriate transfer prices be established for intra-group and/or intra-firm transfer of goods, intangibles and services.

Keywords: Transfer Pricing, Financial Reporting, Arm’s Length Principle.

1. Introduction
Recent developments in technology, transportation and communication, have paved the way for a preponderance of multinational companies to coordinate and control the activities of their subsidiaries from anywhere in the world. Today, it is a fact that a reasonable volume of global trade consists of “intra-group” transactions which involve the international transfer of goods and services including capital and intangibles within a group of companies. As a matter of fact, researches have shown that intra-group trade is growing very rapidly and arguably accounts for over 30 percent of international transactions. The nature of these intra-group or intra-firm transactions is determined by a combination of market driven and group driven forces which could differ from the open market conditions that operate between independent entities. This is to say that a large number of international transactions are no longer influenced by the open market forces. They are rather influenced by some forces which tend to satisfy the common interests of entities within the group. This kind of situation gives birth to the issue of establishing an appropriate price for intra-group or intra-firm transfer of goods, intangibles and services. This “reasonable price” is what we call the transfer price. And the process of generating this price is referred to as transfer pricing. Transfer pricing is therefore, the method of determining the price of goods, intangibles, and services in transactions between related parties or commonly controlled companies. The importance of transfer pricing cannot be overemphasized for so many reasons, including the assurance of minority investor or creditor interests in corporate subsidiaries. Transfer pricing has income tax consequences which of course, is more pronounced when the parties to the transactions are taxed in different jurisdictions. Although intercompany transactions are usually eliminated when the financial statements of controlled foreign companies and their domestic parents are being consolidated, but for tax purposes, such entities are not consolidated and the transactions are therefore not consolidated. The allocation of group wide taxable income across national tax jurisdictions is affected by transfer prices. Hence, a company’s transfer pricing policy can directly affect its after tax income to the extent that tax rates differ across national jurisdictions. In effect, transfer pricing determines the income or loss from related party transactions and it is subject to each
jurisdiction’s tax practice. Transfer pricing applies to most intercompany transactions, including sales of tangible property, sales of licenses of intangible property, services, leases, and financial assets.

The determination of an appropriate transfer price is based on the “arm’s length” standard. This standard tests what would have occurred in a comparable transaction between unrelated parties. The tax authority may adjust the reported taxable income or loss if it considers another price more reasonable. This adjustment may result to a corresponding adjustment in another taxing authority where an affiliate resides. However, the relevant tax authorities in Nigeria are authorized by law to adjust the taxable income between two related parties in order to reflect more accurately, the income earned by each party. The Revenue in this regard, adopts the “arm’s length” standard in determining the true taxable income of a controlled taxpayer. For a transaction to meet the arm’s length standard, the income realized from it must be consistent with that which would have been realized in a transaction engaged by unrelated parties dealing with each other under comparable circumstances. The arm’s length standard does not only apply to the transfer of tangible goods. It also applies to intercompany services.

Today, tax authorities all over the world are paying greater attention to transfer pricing as a result of the globalization of businesses and increase in foreign income. Multinational companies and tax authorities are entering into advance pricing agreements (APAs) as a way of responding to the increasing scrutiny and worldwide information sharing. APAs represent an agreed upon transfer pricing methodology that is based on a predetermined financial metric such as the operating margin. And these APAs could be unilateral. They can also be bilateral. The provision of inter-group services, inter-group financing, and the use of intellectual property legally owned by a particular group member are some of the transactions that are subjected to the arm’s length scrutiny. It is advisable to set transfer prices for transactions between member companies in a group or even branches in a firm. It should be noted however, that transfer pricing in itself does not necessarily involve tax avoidance. Rather, it is a situation where the pricing does not conform to the applicable international norms and/or domestic laws that we can describe as “mispricing”, “incorrect pricing”, or “unjustified pricing” and as such, the issue of tax avoidance or even evasion may arise. The issue of transfer pricing in relation to financial reporting is often associated with uncertain tax positions – that is, the extent to which tax reserves may need to be recorded due to uncertainty with respect to tax return positions (PWC 2011). There are other very important financial reporting implications of transfer pricing. Hence, this study is aimed at examining how transfer pricing impact on financial reporting. Other objectives of this paper are to review the evolution of transfer pricing, the issues that are associated with transfer pricing as well as the challenges of transfer pricing in Nigeria. This study is a thorough literature review of transfer pricing which has been organized to cover the evolution of transfer pricing, the arm’s length principle in transfer pricing, transfer pricing methods, transfer pricing in Nigeria, transfer pricing and business restructuring, and issues and challenges associated with transfer pricing.

2.1 The Evolution Of Transfer Pricing

It is imperative to point out here that transfer pricing has a lot to do with the economic principles that apply to a fluid market place. However, new approaches and techniques to arrive at the appropriate transfer price from the perspective of one or more actors in the system are constantly being evolved. The Organization for Economic Cooperation and Development (OECD) guidelines which was published in 1995, represent a consensus among the OECD member countries most of which are developed nations. The guidelines have been adopted to a very large extent, in domestic transfer pricing regulations. Another transfer pricing framework of note which has evolved over time is the USA Transfer Pricing Regulations (26 USC 482). As a matter of fact, transfer pricing as it is today, is about the most important tax issue globally. The reason is because what we refer to as “multinational companies” in Nigeria include both large corporate groups and smaller companies that have one or more subsidiaries or permanent establishments in countries other than those where the parent company or head office is located. The parent companies of large multinationals usually have intermediaries all over the world. Hence decision making in such organization may be highly centralized or decentralized, depending on the organizational structure, with profit responsibility allocated to member companies in the group. Transfer pricing, as stated earlier, has become a high profile issue over the past few decades as a result of the following reasons among others:

i. the continuous relocation of production components and finished goods from one country to another

ii. the rise of new economies and infrastructure in the developing countries

iii. skilled labour


iv. low production costs

v. conducive economic climate

vi. the all-time trading in financial instruments and commodities

vii. the rise and development of electronic commerce and electronic business.

Most developing countries have in the recent past, modified their transfer pricing legislations to address the issue of foreign multinational companies in their countries that pay so low amount of tax vis-à-vis the domestic companies. The OECD Committee on Fiscal Affairs has continued to monitor developments in transfer pricing, especially with respect to developments in the use of profit-based methods, and in comparability matters. Out of Article 9 of the OECD Model Convention has emerged what is known as the OECD Guidelines which have also been applied in the context of the UN Model Double Tax Convention. The European Commission also came up with proposals on income allocation to members of multinational enterprises (MNEs) that were active in the European Union (EU). Some of the approaches considered have included the possibility of a “common consolidated corporate tax base (CCTB)” and “home state taxation”. Under both options transfer pricing would be replaced by formulary apportionment, whereby taxing rights would be allocated between countries on the basis of apportionment of business activities conducted by the MNEs in those European countries. In 1988 the United Nations contributed to the course of transfer pricing by publishing its report on “International Income Taxation and Developing Countries”. That report discussed some possible means through which the MNEs can manipulate transfer pricing to the detriment of developing countries’ tax bases. The report further recommended some mechanisms by means of which developing countries could deal with inter-group transactions.

Also, in 1999, the United Nations Conference on Trade and Development (UNCTAD) published another report on Transfer Pricing. However, through the “United Nations Practical Manual on Transfer Pricing for Developing Countries”, the United Nations is playing a leadership role in trying to arrive at updated global transfer pricing guidance which can be used by countries all over the world in the event of developing and implementing their transfer pricing regulations. As a draft version, in 1963, the OECD Model Convention was first published. Then in 1977, the final version was first published. Prior to this work by the OECD, the League of Nations had already done some work in that regard followed by the United Nations after the Second World War. The United Nations, however, produced a UN Model Convention for Treaties between Developed and Developing Nations in 1980 and thereafter published a version in 2001. The UN Model Convention was later updated and launched as the 2011 Update in March, 2012. Though the UN Model is quite similar to the OECD’s, there are still areas of differences, particularly in relation to developing countries. It has become an established fact, especially amongst scholars that the OECD Model is more appropriate when it comes to negotiations between developed countries. But for developing countries, it is not very suitable. However, it would not be out of place to say that the UN Model preserves more taxation rights to the source state or capital-importing country than the OECD Model. The UN Model has been embraced by many developing states as the basis of their treaty policy. Some developed countries also adopt some UN Model provisions which most times, has influenced changes to give aspects of the OECD Model a greater source country orientation.

Today, the arm’s length principle is universally applied because it forms the basis for an extensive network of bilateral income tax treaties among OECD member countries, between OECD member countries and non OECD economies, and of transfer pricing rules in nearly every country’s domestic legislation. In 1979, the OECD developed practical guidelines to be adopted in the implementation of the arm’s length principle. However, the OECD Transfer Pricing Guidelines (TPGs) for Multinational Enterprises and Tax Administrators are always being revised and updated with new guidelines in order to adequately address the changes and challenges posed by the dynamic globalized economy. In 2010, the OECD TPGs were revised to take account of the revision of the guidelines on comparability and profit methods. The result of this development was the revision of chapters one to three of the OECD TPGs and the new guidelines on the transfer pricing aspects of business restructuring.

### 2.2 The Arm’s Length Principle In Transfer Pricing

The “arm's-length principle” of transfer pricing states that the price at which a product is exchanged between related parties should be the same and equal to that which ought to have been charged if the parties were not related. An arm's-length price for a transaction is therefore the price of the transaction in the open market. For commodities, determining the arm's-length price, sometimes, can be as simple as looking at comparable prices.
from non-related party transactions. But when it comes to proprietary goods and services or intangibles, determining the arm's length price is usually very complicated. However, the US transfer pricing law requires that the “best method rule” should be used in determining the most appropriate transfer pricing method to be applied in ascertaining the arm's-length price of a given transaction. The "best method rule" of transfer pricing requires that the methodology used to determine the transfer price should be one that offers the greatest precision in matching the price of an arm's-length transaction between unrelated parties. Some countries leave the taxpayer to decide which method is most appropriate for a given transaction, while others require that a particular method be employed.

The following processes are important when it comes to determining the appropriate arm’s length price to be used for a given transaction:

- Comparability analysis
- Evaluation of transactions
- Evaluation of separate and combined transactions
- Use of arm’s length range
- Use of multiple year data
- Losses
- Intentional set-offs and
- Use of customs valuation.

**Comparability analysis:** When it comes to the application of the arm’s length principle, the concept of establishing comparability is indispensable. An analysis under the arm’s length principle involves information on associated companies that are party to the controlled transactions, the transactions at issue between the associated companies, the functions performed and the information derived from independent companies engaged in uncontrolled transactions. The objective of comparability analysis is always to seek the highest practicable degree of comparability, recognizing that there will be unique transactions and cases where any applied method cannot be relied on. It is clear that the closest approximation of the arm’s length price will be dependent on the availability and reliability of comparables. While embarking on transfer pricing analysis, one needs to consider the following factors because they determine the comparability of transactions:

i. Characteristics of the property or service

ii. Functional analysis (Functions, Assets and Risks)

iii. Contractual Terms

iv. Market Conditions


Some property, tangibles or intangibles, and even services may have different characteristics which could lead to differences in their values at the open market. This is to say that such differences must not only be accounted for, but considered in comparability analysis. Some of the characteristics that need to be considered are:

- For tangibles, the physical features, quality, reliability and availability, as well as volume and supply
- For intangibles, the type and form of property, duration and degree of protection as well as the anticipated benefits from use of the property
For services, the nature and extent of such services.

When independent companies are involved in a transaction, the associated compensation is usually reflected in the functions performed by each company, taking into consideration the assets used and the associated assumed risks. Therefore, in determining whether controlled and uncontrolled transactions are comparable, one needs to carry out a study of all specific characteristics of an international transaction or functional activity. This will also include a comparison of the functions performed, assets used, and the risks assumed by the affected parties. This kind of comparison is done on the basis of a functional analysis. Functional analysis is a key element in a transfer pricing exercise. It is the starting point and lays down the foundation of the arm’s length analysis. The purpose of functional analysis is to describe and analyze the operations of a company and those of its associated companies. A functional analysis seeks to identify and compare the economically significant activities and responsibilities undertaken by the independent and associated companies. An economically significant activity is considered to be any activity which materially affects the price charged in a transaction and the profits earned from that transaction. However, functional analysis deals with the identification of the “functions performed”, “assets employed”, and “risks assumed” with respect to the international transactions of a company. The following functions are necessary in the determination of the comparability transactions:

- Research and development
- Product design and engineering
- Manufacturing, production and process engineering
- Product fabrication, extraction and assembly
- Marketing and distribution functions, including inventory management and advertising activities
- Transportation and warehousing
- Managerial, legal, accounting and finance, credit and collection, training and personnel management services
- Outsourcing nature of work
- Business process management.

However, some of the risks that need to be considered in the course of determining the extent of comparability of controlled and uncontrolled transactions are:

- Financial risks including method of funding, funding of losses, and foreign exchange risk
- Product risk including design & development of product, after sales service, product liability risk, intellectual property risk, risks associated with R&D, obsolescence/upgrading of product
- Market risks including fluctuations in prices and demand, business cycle risks, development of market including advertisement and product promotion
- Credit and collection risks;
- Entrepreneurial risk including risk of losses associated with capital investment
- General business risks associated with the ownership of plant, property and equipment.

While it is important to identify the risks associated with transactions, it is even more important to identify who bears such risks. Risks are usually allocated on the basis of the contractual agreement between the parties.
However risk allocation may not always reflect the reality of a transaction or a relationship, especially when it is between controlled taxpayers after the outcome of such risk. This case is usually said to lack economic substance. The terms and conditions of a contract guide the conduct of the contracting parties and have to be carefully analyzed in the course of determining the transfer prices. The market prices for which similar and/or the same products are transferred may not be the same in different markets. This is due to the cost differentials that prevail in the markets. Markets can be different for a good number of reasons. However, geographical location, government rules and regulations, level of the market, are some of the market conditions that can influence the analysis of transfer pricing.

**Evaluation of transactions:** Transactions that have actually been undertaken should not be compromised in course of establishing the arm’s length price except in very special cases where the economic substance of the transaction differs from its form.

**Evaluation of separate and combined transactions:** This has to do with whether the analysis is required to be carried out with respect to individual international transactions or a group of international transactions that are economically connected.

**Use of arm’s length range:** this has to do with the setting up of a range of acceptable and comparable prices as against a single transfer price for controlled transactions. This range is necessary because the transfer pricing methods tend to reflect the prices and conditions that exist between independent parties.

**Use of multiple year data:** The use of multiple year data creates the avenue for data to be better harmonized, as it tends to average the results over a period of time. Multiple year data have the ability to reveal some abnormal economic factors like strikes that affect the results. Such an approach also tries to test the data thrown up in typical business cycles thereby eliminating the risk of testing only the data of a particularly year-good or bad.

**Losses:** The fact that a particular company, out several others in a group, is making losses even when the entire group is very profitable does not call for scrutiny by the relevant tax authority. The factors responsible for this kind of loss should be identified and addressed because they significantly influence how such will be treated with respect to transfer pricing.

**Intentional set-offs:** This occurs in a situation where a company provides a certain benefit to an associated company in the same group and this benefit is compensated by another benefit in return. However, some Set-offs can be quite complex in the sense that they may involve a series of transactions. The parties involved in the set-off are expected to accurately disclose all set-offs and have sufficient documentation to back up their set-off claims so that the conditions governing the transactions would still be consistent with the arm’s length principle.

**Use of customs valuation:** Customs valuation refers to the process through which the values of imported goods are determined. The General Agreement on Tariff and Trade (GATT) which is a part the World Trade Organization (WTO) set of agreements, has specified some principles for an international system of custom valuation. Member countries of WTO have typically harmonize their internal legislation in terms of customs valuation in accordance with the provisions of WTO agreement on customs valuation. Under normal circumstances, the documented custom valuation may be used as justification for the transfer prices of imported goods in international transactions between associated companies. However, the arm’s length principle is applied by many customs administrations as a principle of comparison between the value attributable to goods imported by associated companies and the value of similar goods imported by independent companies. The computation of an arm’s length price using transfer pricing analysis is a complex task which requires a lot of effort and good will from both the taxpayer and the tax authorities in terms of documentation, groundwork, analysis, and research.

### 2.3 Transfer Pricing Methods

This study will examine the following five transfer pricing methods:

i. **Comparable Uncontrolled Price (CUP)**

ii. **Resale Price Method (RPM)**

iii. **Cost Plus (CP)**
iv. Profit comparison method (CPM)

v. Profit-split methods.

**Comparable Uncontrolled Price (CUP):** Under this method, the price charged for in respect of a property or service transferred in a controlled transaction is compared with that charged in respect of a comparable property or service transferred in an uncontrolled transaction.

**Resale Price Method (RPM):** As the name implies, the Resale Price Method is applied to establish the resale price of a product that was purchased from an associated company when such product is resold to another independent company. The resale price is expected to be set at such a margin that the reseller would be able to recover his purchase, selling and distribution costs and also make profit.

**Cost Plus (CP):** The Cost Plus Method is used when it is necessary to determine a transfer price by adding a certain margin to the costs incurred by a supplier over the costs of the property or service which he transfers to a related purchaser to enable him make some profit.

**Profit comparison method (CPM):** This method is concerned with the determination of a certain level of profit that would have been realized from a controlled transaction when placed side by side with that realized by an independent company in an uncontrolled transaction.

**Profit-split methods:** Here the combined profit earned by two related parties from one or more transactions are divided using a basis that is economically defined with the aim of replicating the division of profits that would have been anticipated in an agreement made at arm’s length.

### 2.4 Transfer Pricing In Nigeria

As a developing nation with a wealth of natural resources including proven oil and gas reserves and significant mineral deposits Nigeria is enjoying an increasing influx of foreign investment and business activity. As a result of the establishment of multinational companies in Nigeria and the increased volume of intercompany transactions both in terms of the number and the value between these local affiliates and their foreign counterparts, transfer pricing is a matter of serious concern to the Federal Inland Revenue Service (FIRS). In an attempt to combat perceived income shifting by foreign taxpayers out of Nigeria, FIRS published new transfer pricing rules on September 21, 2012. These latest rules signal a new level of sophistication of the Nigerian government in terms of addressing international commerce and taxation and reflect the move toward formal transfer pricing rules in other developing nations. Consequently, it is critical for corporate taxpayers and their advisors to educate themselves on the new rules and understand the trends and precedents set by this recent legislation in the context of their own business strategy in the region. There have always been rules in the Nigerian tax laws the guide related party transactions. These are contained in the anti-avoidance provisions embedded in various tax laws particularly in Section 22 of the Companies Income Tax Act (CITA) Cap C21, LFN 2004, as amended by the CIT (Amendment) Act of 2007. This section provides that “Where the Board is of the opinion that any disposition [defined as trust, grant, covenant agreement or arrangement] is not in fact given effect to or any transaction which reduces or would reduce the amount of any tax payable is artificial or fictitious, it may disregard any such disposition or direct that such adjustments shall be made as respects liability to tax as it considers appropriate so as to counteract the reduction of liability to tax affected, or reduction which would otherwise be affected, by the transaction and any company concerned shall be assessable accordingly”. The section further provides that transactions between related persons shall be deemed to be artificial or fictitious if, in the opinion of the Board, those transactions have not been made on terms which might fairly have been expected to have been made by persons engaged in the same or similar activities dealing with one another at arm’s length. The Petroleum Profits Tax Act (PPTA) has a similar provision in Section 15. So has the Personal Income Tax Act (PITA) in Section 17. Going by the rules, they were rather too broad and loose to give any guidance to the taxpayers or the tax authority on how transfer prices can be determined. In the absence of proper Transfer Pricing Guidelines, the Court did not envisage any situation where a tax authority could effectively challenge any pricing model adopted by a company with respect to its related party transactions. However, the FIRS has decided to introduce detailed Transfer Pricing rules. This decision of course, is a good step in the right direction. It will provide a common basis for the review of taxpayers’ financial records during the audit of related party transactions.
2.5 Transfer Pricing And Business Restructuring

Nigeria as well as other developing countries have followed the ongoing OECD project that on how to reach a consensus concerning how the arm’s length principle will apply to business restructurings involving the cross-border redeployment of operations by a multinational company. Such restructurings can affect the way profits and losses are allocated among the members of the multinational group. It also affects the corporate income tax paid in each of the countries where the group operates. The arm’s length principle and the OECD Transfer Pricing Guidelines can help to proffer solutions to some of these issues. It is a common practice for multinational companies to restructure their business operations. Business restructuring activities such as cross-border redeployment of assets, risks, and functions usually have transfer pricing implications. Some common forms of restructuring usually result in limited risks and cost plus transfer pricing arrangements. There are other forms of restructuring that has to do with the regionalization of intangibles and as such, may require a company to migrate a portion its intangibles between jurisdictions. When there is intercompany transfer of assets, the income tax effects are generally not recognized immediately in the consolidated financial statements.

The OECD Model Tax Convention provides for issues that border on double taxation to be resolved between the states concerned by following the Mutual Agreement Procedure which deals with an increasing number of complex international tax disputes, including tricky transfer pricing disputes (www.oecd.org/ctp/memap). The OECD Model Tax Convention now includes compulsory, binding arbitration procedures for cases left unresolved after two years of Mutual Agreement Procedure. Nigeria just as other developing countries are very much aware of the challenges posed by transfer pricing. Thus they have a major aim just like the OECD to protect their tax base and at the same time avoid hampering foreign direct investment and cross-border trade. The arm’s length principle will no doubt, help them achieve that goal. All it requires is to tailor the legislative measures and administrative effort to the strategic needs and resources of each country. Applying the arm’s length principle can become complex and resource-intensive, though policymakers should bear in mind that most OECD countries started modestly and built their transfer pricing legislation and practices gradually over several years. Indeed, they are still in the process of improving them. It is an indispensable condition that Nigeria should implement transfer pricing legislation. By so doing, the FIRS should focus on the most common types of transactions and sectors in the economy first, for instance the exploitation of natural resources, manufacturing, or service activities. Enforcement objectives should be realistic, given the available capacity, and compliance requirements made reasonable for taxpayers in light of the size of the cross border trade. Given the global and sometimes controversial nature of transfer pricing, it is important to develop internationally shared principles to help each country fight abusive transfers of profit abroad, while at the same time limiting the risk of double taxation of those profits. This is what the arm’s length principle is for. As more developing countries apply it, new lessons will be learned. This is a key step on the road to building a stronger, cleaner and fairer world economy.

2.6 Issues And Challenges Associated With Transfer Pricing

It is advisable for Nigerian companies that are members of a group of companies-multinational or local to take very practical and coordinated steps directed towards understanding transfer pricing, the requirements of transfer pricing, the risks associated with transfer pricing and how to address them. However, the following are some of the common challenges that are faced by companies implementing TP, especially in developing countries like Nigeria:

- Lack of knowledge and requisite skill on Transfer Pricing
- Identifying all the transactions (goods, services, intangibles) that are subject to the arm’s length rule is tedious. Some are often omitted. For example, inter-company finances and guarantees, as well as shutdown costs.
- Applying the arm’s length principle is difficult and time-consuming
- Lack of data on comparables especially in a local environment
- Determining appropriate comparable database to be used
Customs-related challenges such as customs valuation

Ensuring consistency in the application of global corporate Transfer Pricing policies and adherence to local requirements

Addressing the issues in the interaction between secondment contracts, and personal taxation

Avoiding double taxation impact of Transfer Pricing adjustment carried out in one country only

The application of Transfer Pricing in a Joint Venture environment

Transfer Pricing and tax residency risks

Managing indirect charges in a Transfer Pricing environment.

3. Summary And Conclusion

Transfer pricing is a global issue which has caught the attention of such international organizations as the United Nations Conference on Trade and Development and the Organisation for Economic Cooperation and Development (OECD). It is an issue that deserves to be given the much needed attention to ensure that it is addressed appropriately. Otherwise, multinational companies would take advantage of it and embark on profit shifting from where value is created to lower tax economies. This practice would in turn, portend great danger to the affected economies. Thus, profit shifting should be managed and controlled because most governments depend greatly on tax revenues for driving economic development. And for the management and control of profit shifting to be carried out effectively, some sort of international cooperation is required. However, this paper has identified transfer pricing as a one of the major issues confronting multinational companies in the business world today. The impact of transfer pricing arrangements and analysis on financial reporting cuts across multiple areas ranging from the preparation of separate company financial statements, acquisition accounting, business restructuring, to valuation allowances. However, the cause and effect relationship of transfer pricing to pre-tax and income tax accounting should be given serious attention when financial statements are being prepared. The implementation of transfer pricing poses some sort of difficulty to the government and taxpayers alike. This is partly due to the amount of resources involved which in most cases include skilled human resources and cost compliance. On the side of the government, the administration of transfer pricing requires a whole lot of resources, and most developing countries do not have such resources at their disposal to be able to effectively administer their transfer pricing regulations. The world has no doubt, become a global village with its implications for businesses in diverse geographical locations. In the increasing global business environment, many multinational companies do not consider national borders an impediment to conducting business hence, cross-border business activities are on the increase. But the challenge is that fiscal authorities are finding it difficult to track economic activities within their territories to harness the associated benefits to stimulate the growth of local economies. Nevertheless, it is strongly recommended that appropriate transfer prices be established for intra-group and/or intra-firm transfer of goods, intangibles and services.

References


Clyde L. (1929): Ayrshire Pullman Motor Services and D.M. Ritchie v. The Commissioners of Inland Revenue, Court of Session (Scotland), First Division, 14 TC 754 (1929), at 763-764.


Douglas A. S. (1993): Discussion of the impact of U.S. tax law revision on multinational corporations’ capital location and income-shifting decisions and geographic income shifting by multinational corporations in response to tax rate changes, 31 J. ACCT. RES.


